SECURED TRANSACTIONS *for* THE PRACTITIONER

HOW TO PROPERLY PERFECT YOUR PERSONAL PROPERTY LIEN AND ASSURE PRIORITY

2018 EDITION

FRANK PERETORE
AND
ROBERT HORNBY

ISBN: 1496078632
ISBN 13: 9781496078636
Library of Congress Control Number: 2014903928
CreateSpace Independent Publishing Platform
North Charleston, South Carolina

HOW TO MAKE THE MOST OF THIS BOOK

We have designed this book as a practical guide for properly perfecting personal property liens and assuring priority. Each chapter is meant to assist the practitioner with navigating this process and includes "PRACTICE TIPS" which highlight important issues that may arise.

Read Chapter I, to review the scope of Article 9 including the major types of personal property not covered by Article 9, in whole or in part, and to briefly review some of the more significant and unique conceptual aspects of Article 9 such as the limited liability of secured parties, the ways in which secured parties and assignees may limit an obligor's defenses, and the free alienability provisions which often supersede contract provisions and even laws that restrict a debtor's ability to grant a security interest or a party's ability to assign personal property interests.

Whenever doing a new transaction, review Chapter II to assure satisfaction of Article 9's requirement of "Attachment". Then review Chapter III, sections "A" and "B", to determine how Article 9 categorizes your collateral and how to perfect a lien in such collateral, respectively. If there are any questions regarding how to perfect a lien by filing, possession or control, review subsections "C", "E" and "F" of Chapter III, respectively. Review Chapter V to make sure there are no "secret liens" that may have been overlooked.

Post-closing, if there have been any changes in the circumstances of the collateral or the parties, review subsection "D" of Chapter III to determine what, if any, steps must be taken to continue perfection and priority. Whenever there is an issue or dispute about priority, turn to Chapter IV. For any questions about creating or the priority of a Purchase Money Security Interest ("PMSI") review subsection "G" of Chapter IV.

Finally, to understand the collision of Article 9 and the U.S. Bankruptcy Code and fraudulent conveyance issues, review Chapter VI.

IMPORTANT ISSUES FOR CLOSING A TRANSACTION

Quick Article 9 closing Checklist

1. Is some or all of the collateral covered by Article 9? (See Chapter I).
2. Is there an "attachment" under Article 9? (See Chapter II).
3. How does Article 9 categorize the collateral? What is the "type" of collateral? (See Chapter III, Section A).
4. Based upon the type of collateral, how is the lien perfected? (See Chapter III, Section B and Sections C, E & F respectively for perfecting by filing,[1] possession and control).
5. How is the lien perfected to obtain and assure first priority? Are there any secret liens? (See Chapters IV and V, respectively).
6. Is there any exposure to a subsequent bankruptcy filing or fraudulent conveyance claim? (See Chapter VI).
7. What, if any, action should be taken post-closing to preserve perfection and priority? (See Chapter III, Section D).

---

1 Whenever perfecting by filing, be sure to at least ask the following additional questions: (1) How to identify the debtor? (2) How to describe the collateral? (3) When and where to file? and (4) Are there any unique state law issues regarding the filing?

TABLE OF CONTENTS

I

SCOPE OF ARTICLE 9, BASIC TERMINOLOGY AND BASIC CONCEPTS

The operative statute governing liens in personal property is Article 9 of the Uniform Commercial Code (the "U.C.C."). Article 9 applies to tangible, quasi-tangible and intangible personal property, from equipment and inventory to promissory notes and electronic chattel paper. Article 9 has its origins in the Industrial Revolution. Before the Industrial Revolution one could not pledge personal property as collateral. Pledging personal property was even a crime. With the Industrial Revolution it became apparent industry required more alternatives for financing. Various forms of personal property liens such as the pledge and the chattel mortgage developed. Originally proposed by the drafters in 1952, and now adopted by all states and the District of Columbia in some form, Article 9 of the U.C.C. brought uniformity to the patchwork of common law personal property lien laws.

Substantially revised several times since its original enactment, Article 9 seeks to facilitate financial transactions by fostering predictability. Article 9 endeavors to simplify the law, create transparency, and remove impediments to initial secured financings as well as secondary markets and securitizations.

Article 9 includes a few types of personal property and transactions one might not expect to be governed by Article 9. Some of the more unusual categories of personal property included and excluded from Article 9 are listed below.

(A) Personal Property Included Under Article 9

(i) ***Assignments For The Benefit of Creditors:*** A security interest and the initial assignment for the benefit of creditors along with subsequent transfers by the transferee. U.C.C. § 9-309(12).[2]

(ii) ***Consignments:*** Most consignments are now treated under Article 9 like a purchase money security interest ("PMSI"), which will be discussed more fully below. U.C.C. § 9-109(a)(4).[3]

There are still, however, three categories of consignments exempt from Article 9: (1) consumer goods consigned to a merchant; (2) consignments totaling under $1,000 each; and (3) goods delivered to a merchant "generally known by its creditors to be substantially engaged in selling the goods of others."[4]

PRACTICE TIP: As discussed more fully below, while true consignments do not require a written security agreement under Article 9, they do require the filing of financing statement. Because it is often difficult to determine with certainty whether a transaction will be deemed a true consignment, it is advisable that the practitioner, out of an abundance of caution, comply with the security agreement and filing

2 The liens are deemed perfected upon attachment without filing. See U.C.C. § 9-309(12) cmt. 8.

3 "Security interest" includes any interest of a consignor. U.C.C. § 1-201(b)(35). Pursuant to U.C.C. § 9-102(20), "consignment ... means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale...." Note that a "sale" need not be the exclusive reason for the delivery of the goods. U.C.C. § 9-102 cmt. 14. See Georgetown Steel Co., LLC v. Progress Rail Servs., Corp. (In Re Georgetown Steel Co., LLC), 318 B.R. 352, 358 (Bankr. D.S.C. 2004) (iron was delivered for sale although merchant processed the iron into steel prior to sale). But, if the collateral was only delivered to the seller for storage, there is no consignment, only a bailment and Article 9 does not apply. In Re Greenline Equip., 390 B.R. 576 (Bankr. N.D. Miss. 2008). Consignments are often inventory under Article 9, and thus, a secured party must be sure not only to file a financing statement, but also to comply with the inventory special timing and notice provisions. In Re Salander-O'Reilly Galleries, LLC, 506 B.R. 600 (Bankr. S.D.N.Y. 2014).

4 See U.C.C. § 9-102(a)(20). A creditor's actual knowledge that the consignee is "substantially engaged in selling the goods of others," is usually sufficient for a court to subordinate the creditor's interest. In Re Fariba v. Dealer Servs. Corp., 100 Cal. Rptr. 3d 219, 221, 70 U.C.C. Rep. Serv. 2d 193, 200-203 (Cal. Ct. App. 2009). See also, Belmont Int'l Inc. v. Am. Int'l Shoe Co., 831 P.2d 15 (Or. 1992); 3A David Frish, Anderson on the Uniform Commercial Code § 2-326:94 (3d ed. 2009).

requirements of Article 9. Article 9 expressly provides that filing a UCC-1 is not an admission that a transaction is not a consignment.[5]

(iii) ***Commercial Tort Claims:*** A limited category of commercial tort claims fall under Article 9. This category includes only business claims arising in tort. It does not include claims for damages arising out of personal injury or death. U.C.C. § 9-102(13).[6]

(iv) ***Health Care Insurance Receivables:*** Claims under an insurance policy are generally excluded from Article 9, except to the extent they are proceeds of other collateral. Health care insurance receivables are the exception. U.C.C. §§ 9-109(d)(8), 9-102(2) and 9-102(46).

(v) ***Letter of Credit Rights:***[7] Article 9 applies to the "right to payment and performance under a letter of credit." Article 9, however, specifically excludes the "right of a beneficiary to demand payment or performance under a letter of credit." This subject is governed by Article 5 of the U.C.C.[8]

(vi) ***Nonpossessory Statutory Agricultural Liens:*** As discussed more fully below, Article 9 is generally limited to consensual liens and excludes involuntary statutory liens such as garage keeper's and landlord's liens.

---

5 See U.C.C. § 9-505(b).

6 Commercial tort claims may not be the subject of an after-acquired clause, but may be proceeds of other collateral. U.C.C. §§ 9-204(b)(2), 9-102(a)(64), 9-203(f) and 9-315. A breach of contract claim is likely to constitute proceeds of accounts or a general intangible. See Sams v. Redevelopment Auth. of City of New Kensington, 261 A.2d 566, 7 U.C.C. Rep. 336 (Pa. 1970). The payment obligation under the settlement of a lawsuit, even a personal injury suit, is a payment intangible. U.C.C. §9-109. cmt. 15.

7 There are virtually no defenses to letters of credit making these instruments generally preferable to guaranties and sureties.

8 See U.C.C. § 9-102(a)(51). There are actually three sources of law governing letters of credit: (1) U.C.C. (Article 5); (2) Uniform Customs and Practice For Documentary Credits (U.C.P.) (revised in 1993, and reissued as ICC Publication No. 500); and (3) the International Standby Practices (ISP98). The U.C.P. and ISP98 are not laws, but rather rules incorporated into letters of credit by the parties. The U.C.C. covers letters of credit issued by banks and others. Under the U.C.C., a letter of credit is irrevocable unless it provides otherwise. U.C.C. § 5-106(a). Under the U.C.P. and ISP98, all letters of credit are irrevocable. U.C.P. art. 2 and 3; ISP98 Rule 1.06.

Article 9 does, however, apply to nonpossessory statutory agricultural liens. U.C.C. § 9-109(a)(2).

(vii) ***Public Finance Transactions:*** Government-created security interests are included within Article 9 unless specifically preempted by a state statute that governs creation, perfection, priority and prosecution of the security interest. U.C.C. § 9-109(c)(2).

(viii) ***Sales of Accounts, Chattel Paper, Payment Intangibles or Promissory Notes:*** This aspect of Article 9 is counterintuitive. Article 9 is not limited to a pledge of accounts, chattel paper, payment intangibles or promissory notes as collateral, but also includes an outright purchase and sale of these types of collateral. U.C.C. § 9-109(a)(3).[9]

Note: Payment intangibles and promissory notes are sub-categories of general intangibles and instruments, respectively. Article 9 does not apply to sales of general intangibles (other than payment intangibles); these sales are governed by common law. Article 9 does not apply to sales of instruments (other than promissory notes); these sales are governed by Article 3 and the common law.

(ix) ***Security Interests Arising Under Articles 2, 2A, 4 and 5 of the U.C.C.:***

- An Article 2 sales security interest arising under U.C.C. § 2-401 – when a security interest is created by a sale subject to a reservation of title.

9 "Security interest" includes "a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9." U.C.C. § 1-201(b)(35). It is often not clear whether a transaction is a true sale or a sale intended as security, especially where there is any form of recourse. See Citizens Bank & Trust Co. v. Security First Ins. Holdings, LLC (In Re Brooke Capital Corporation), 588 Fed. Appx. 834, 85 U.C.C. Rep. Sevr. 2d 348 (10th Cir. 2014) (Participation interest not a true sale); In Re Commercial Money Ctr., Inc., 350 B.R. 465 (B.A.P. 9th Cir. 2006). This sale vs. loan issue often turns on the nature and extent of recourse of the buyer to the seller, especially since the parties' characterization of the transaction generally does not govern. U.C.C. § 1-203. (Texas and Louisiana adopted non-uniform provisions of the U.C.C., which provide that the parties' characterization governs.) Article 9 makes clear, however, the fact that a buyer may have some level of recourse does not preclude a true sale. See U.C.C. § 9-607 cmt. 9, which, in addressing whether a buyer (secured party) must act in a commercially reasonable fashion in foreclosing an interest in accounts, chattel paper, payment intangibles or promissory notes, provides that the buyer (secured party) must meet the commercial reasonableness standard, if there is recourse, "even though the assignment to the secured party was a 'true' sale." Id. The difference between a sale and a loan can be significant for purposes of usury, accounting, tax, bankruptcy and perfection.

- An Article 2 sales security interest granted under U.C.C. § 2-711(3) to an aggrieved buyer upon rejection of goods.

- An Article 2A lease security interest granted under U.C.C. § 2A-508(5) to an aggrieved lessee upon rejection of goods.

- An Article 4 security interest of a collecting bank under U.C.C. § 4-210; and

- An Article 5 security interest granted under U.C.C. § 5-118 to an issuer or nominated person in a letter of credit and proceeds.

(x) ***Software:*** Software is a sub-category of general intangibles. U.C.C. § 9-102(42).

(xi) ***Supporting Obligations*:** Guaranties,[10] letters of credit and other supporting obligations of a debt (i.e., chattel paper or promissory notes) are generally automatically included when the debt is pledged. See U.C.C. §§ 9-203, 9-308(d).

(B) Personal Property Excluded From Article 9

Despite its breadth, there are many personal property liens excluded from Article 9, at least in part. Additionally, in certain cases Article 9 defers to specific state or federal law for perfection and priority issues, but may still apply in whole or in part to the enforcement of liens.

Below are the major categories of personal property liens excluded from Article 9, in whole or in part.

(i) ***Nonconsensual Liens*:** Article 9 generally governs only consensual liens. Thus, involuntary liens such as garage keeper's liens, landlord's liens and liens in favor of suppliers of services or materials, (with the exception of non-possessory agricultural liens) are beyond the scope of Article 9.[11]

---

10 All guaranties are assignable, and the mere use of "you" does not constitute a "plain intent to restrict the guarantor's liability to the original creditor." Champion Home Builders v. Sipes, 269 Cal. Rptr. 75, 78, 219 Cal. App. 3d 1415, 1422 (1990).

11 See U.C.C. § 9-109(d)(2).

Article 9 generally provides that these involuntary possessory liens will have priority over Article 9 liens unless they are created by statute and the statute gives priority to Article 9 liens.[12] This provision reflects the policy that liens securing work or services that enhance or preserve collateral should take priority.[13] Article 9 generally defers to state law regarding perfection, priority and enforcement of involuntary liens.[14]

(ii) ***Personal Property Liens Specifically Addressed by Federal or State Law:*** Article 9 does not apply to the extent it is superseded by state or federal laws addressed to specific types of collateral. The primary personal property that falls into this category is titled motor vehicles, airplanes, railcars, vessels and intellectual property. Every state has a title law governing motor vehicles that are registered in and driven over the roads in that state. These state title statutes generally require all vehicles that drive over the roads to be registered and titled and that all liens on such vehicles be recorded, typically on the title itself. As for commercial trucks operating under an ICC permit, federal law defers to the state certificate of title laws.[15] State laws, other than Article 9, can also govern perfection of liens in boats and federal law governs railcars and many vessels and airplanes. Copyrights, trademarks and patents are also all governed, at least to some extent, by federal law.

These federal statutes, however, often address only perfection of liens, but not priority or enforcement in which case Article 9 fills in the gaps and applies to the extent it does not conflict with the federal law. A secured party may generally enlist some

12 New York's garage keeper's lien statute trumps Article 9 liens. N.Y. Lien Law Section 184 (2007). The New York garage keeper must, however, be licensed with the state to invoke the statute. See N.Y. C.L.S. Veh. & Tr. §§ 398-b and 398-c. Conversely, Arizona's and New Jersey's garage keeper's lien statutes expressly provide for the priority of a secured party's perfected lien. A.R.S. 33-1022 (B); N.J.S.A. 2A:44-21 (1998). Perfected liens in titled vehicles also trump impound towing and storage charges, in New Jersey. See Midlantic Bank, N.A. v. Wood, 302 N.J. Super. 286, 695 A.2d 335 (N.J. Super. Ct. App. Div. 1997). Nonpossessory liens, such as equitable liens, should not trump Article 9 liens. Bancorp South Bank v. Hazelwood Logistics Center, LLC, 706 F. 3d 888 (8th Cir. 2013). See also, Chapter IV, Section (S)(vi) and (vii), infra.

13 See U.C.C. § 9-310 cmt. 1.

14 See U.C.C. § 9-333.

15 See 49 U.S.C. § 14301(b) (2012).

Article 9 provisions, such as Article 9's self-help provisions, although a federal law governs perfection questions.[16]

Airplanes

The Federal Aviation Act of 1958 governs perfection of a security interest in airplane engines (and propellers) and airplanes.[17] A secured party must file a notice of security interest with the Federal Aviation Administration (FAA) Aircraft Registry to perfect its lien.

Vessels

The Federal Commercial Instruments and Maritime Lien Law govern the perfection of security interests in documented vessels.[18] A secured party needs to file a preferred ship mortgage with the National Vessel Documentation Center. A floating home, however, is not a "vessel." [19]

16 See Dietrich v. Key Bank, N.A., 72 F.3d 1509 (11th Cir. 1996).

17 See 49 U.S.C §§ 44101–44113 (2012). Secured parties should consider using a specialist as an expeditor due to complexities. The Federal Aviation Act only addresses perfection, not priority. Priority is governed by Article 9, except where the Cape Town Convention applies. To obtain priority in larger airplanes (8 or more people or crew or goods in excess of 2,750 kilograms) and helicopters (5 or more people or crew or goods in excess of 450 kilograms) the secured party also needs to record its security interest under the Cape Town Convention by filing with the International Registry in Dublin, Ireland. Registering a security interest under the Cape Town Convention requires two steps. First, the secured party must obtain an authorization code from the FAA. Second, using the FAA authorization code, the secured party must register with the International Registry as provided above.

18 See 46 U.S.C. § 31301 et seq. (2010). This includes the Ship Mortgage Act of 1920, 46 U.S.C. §§ 31301–31343. The Ship Mortgage Act addresses both perfection and priority. For undocumented boats such as recreational vehicles, the secured party should perfect under Article 9, although an undocumented boat may be titled, depending on the state. If there is a title, the secured party should record a lien on it. If the boat cannot be documented because it is too small and it is intended to be used in interstate commerce, the secured party should consider filing with the Surface Transportation Board as well. See Railroad Rolling Stock infra. The secured party should also, in each of these cases, file a UCC-1 covering not only the boat but also all equipment because some equipment may not be covered by the Ship Mortgage Act. The secured party should further be familiar with maritime liens, which can arise in favor of repair yards, stevedores, the master and crew as well as other providers of goods and services to the vessel. Some of these liens will be "preferred maritime liens" and trump even a "preferred ship mortgage".

19 See Lozman v. City of Riverview Beach, Florida, 133 S. Ct. 735 (2013).

Railroad Rolling Stock

The ICC Termination Act of 1995 governs the perfection of security interests in railroad cars, locomotives and other railroad rolling stock.[20] Perfection is effected by filing a security agreement or memorandum with the Surface Transportation Board in Washington, D.C.

Intellectual Property

Case law generally provides that patents, trademarks and unregistered copyrights are governed by Article 9.[21] Patents, trademarks and unregistered copyrights are "general intangibles" under Article 9. Perfecting a security interest in general intangibles is addressed in the Perfecting a Security Interest section below, but, as discussed below, the secured party usually should make a filing at the federal level as well.

Copyrights

Pursuant to the Copyright Act of 1976, secured parties in "registered" copyrights must file a security agreement or a "note" or a "memorandum" in the U.S. Copyright Office.[22] The secured party would be wise to file an Article 9 financing statement as well. As noted above, un-registered copyrights are governed by Article 9.

Trademarks

The Lanham Act, like the Patent Act referenced below, generally requires filings at the federal level for transfers of ownership.[23] In the case of trademarks, the secured

---

20 See 49 U.S.C. § 11301 et seq. (1996). Note that railway rolling stock equipment trusts are excluded from Article 9. Section 20(c) of the Interstate Commerce Act governs them. U.C.C. § 9-109(c)(1). See generally J. Atwood, *A New International Regime for Railway Rolling Stock Asset-Based Financing*, 40 UCC L.J. 3, 307 (Winter 2008).

21 See Moldo v. Matsco (In Re Cybernetic Servs., Inc.), 252 F.3d 1039 (9th Cir. 2001) (patents); Trimarchi v. Together Dev. Corp., 255 B.R. 606 (D. Mass. 2000) (trademarks); Aerocon Eng'g Inc. v. Silicon Valley Bank (In Re World Auxiliary Power Co.), 303 F.3d 1120 (9th Cir. 2002) (unregistered copyrights).

22 See 17 U.S.C. §§ 204, 205 (2010); 17 U.S.C. § 101. See also In Re Peregine Entm't, Ltd., 116 B.R. 194, 11 U.C.C. Rep. Serv. 2d 1025 (C.D. Cal. 1990). The secured party should file the security agreement or a "note or memorandum" of the security interest or mortgage of copyright. 17 U.S.C. § 204. This "note" or "memorandum" should contain the title of the copyright work, the registration number, name and address of the secured party and the notarized signature of the debtor. If the copyright is not registered, perfection is under Article 9. In Re World Auxiliary Power Co., 303 F.3d 1120 (9th Cir. 2002). The secured party should, however, generally register the copyright and then file against it.

23 See 15 U.S.C. § 1060 (2002).

party should, however, file an "assignment" with the Commissioner of Patents and Trademarks,[24] as well as an Article 9 financing statement.

Patents

The Patent Act, like the Lanham Act, arguably only requires filings at the federal level for transfers of ownership.[25] In the case of patents, the secured party should, however, file a "conditional assignment" with the Commissioner of Patents and Trademarks,[26] as well as an Article 9 financing statement.

In summary, in the case of unregistered copyrights, trademarks and patents a filed financing statement should protect the secured party from a subsequent trustee and most creditors,[27] but federal filings are advisable except in the case of an unregistered copyright out of an abundance of caution and to protect against bona fide purchasers without knowledge of the lien. In short, if the collateral rolls over the roads or rails, flies, floats or is intellectual property it is often not governed exclusively by Article 9, at

---

24 The "conditional assignment" becomes effective only upon default and exercise of its rights by the secured party. The secured party could also take a full assignment with a license back to the debtor, but this is more problematic. Under trademark law the owner must control the "nature and quality" of the trademark. Accordingly, a "naked assignment" or "assignment in gross" can vitiate a trademark. Thus, counsel must be careful in structuring the transaction, regardless of the form. Section 10 of the Lanham Act, 15 U.S.C. § 1060, requires assignments of federally registered trademarks to be filed with the U.S. Patent and Trademark Office. If the trademark is registered, the documents should identify the certificate of registration. If the registration is pending, the documents should note that the application is pending and include the serial number, date of filing, name of secured party and the notarized signature of the debtor. If the trademark is pending and is subsequently granted, then the secured party does not need to amend the trademark. See also 37 C.F.R. §§ 3.11-16 and 3.25. One filing may reference multiple trademarks held by the debtor, but the filing will need to be amended as the debtor acquires new trademarks.

25 See 35 U.S.C. § 101 et seq. (2012). See also In Re Cybernetic Servs., Inc., 252 F.3d 1039 (9th Cir. 2001).

26 See 35 U.S.C. § 261 (2012) contemplates that "an assignment, grant or conveyance" or "mortgage" of patents (and patent applications) be filed with the U.S. Patent and Trademark Office. See 37 C.F.R. §§ 3.11-24. The assignment should identify the application with the patent number, date and title of invention. For a pending patent application, give the serial number, date of application and title of invention. If there is not yet a serial number, describe the application, date of the filing, inventor's name and title of invention. Also include the name and address of the secured party. The debtor's signature should be notarized. The secured party should periodically amend to include new patents and patent applications. However, if the secured party filed on a patent application that is pending, it need not file again when the patent is issued.

27 A secured party in a patent that perfects through a financing statement only will not be protected against a bona fide purchaser who buys without knowledge of the security interest.

least for lien perfection and priority issues. Rather Article 9 governs only to the extent it is not preempted.[28]

Equipment Leases

Article 9 does not apply to equipment leases. These are governed by Article 2A,[29] except to the extent the equipment leases themselves are pledged as collateral, in which case they are "chattel paper" under Article 9. Under Article 2A true leases do not require lien perfection because the obligor has no ownership interest in the equipment.[30] Equipment leases must be carefully reviewed, however, before concluding there are no lien perfection issues. If the lease is not a "true lease" under applicable law, but is a "lease intended as security," the liens must be perfected because a lease intended as security is governed by Article 9 and not Article 2A.

The enactment of Article 2A was designed primarily to address the multi-billion dollar equipment finance leasing industry, which does not fit neatly under Article 2 (Sale of Goods) or Article 9 (Secured Transactions). Generally, true leases are governed by Article 2A, and leases intended as security are governed by Article 9 for perfection, default and remedies, and Article 2 for warranties.[31]

U.C.C. § 1-201(37), which was amended simultaneously with the enactment of Article 2A, has eliminated most of the vagaries, disputes, and inconsistencies surrounding the true lease issue. Section 1-201(37) is often referred to as the "bright-line test."[32] The bright line test introduces a two-step test to determine whether an equipment lease is a true lease or a lease intended as security. The test is disjunctive: a lease must satisfy one of two requirements to be deemed a true lease. The first prong of the test considers whether the lessee may terminate the payment obligations under the lease before termination of the lease. Most three-party equipment finance leases will not satisfy this requirement since they provide for unconditional, non-terminable obligations and, indeed, often contain hell-or-high-water provisions precisely to eliminate the lessee's right of termination.

---

28 See U.C.C. § 9-109(c)(1).

29 Article 2A of the U.C.C. has been adopted in every state and the District of Columbia.

30 See GEO Finance v. University Square, 105 F. Supp. 3d 753 (E.D. Mich. 2015).

31 The terms "true lease" and "lease intended as security" are legal terms of art that apply to commercial law and state tax issues. Accounting rules and federal tax law use different terms and standards. In accounting parlance, the terms "operating lease" and "capital lease" correlate to true leases and leases intended as security, respectively. The accounting counterpart to § 1-203 of the U.C.C., which distinguishes a lease from a security interest, is Financial Accounting Standards Board Statement No. 13 (FASB 13), which provides the accounting test for identifying a capital lease. Under federal law, the terms true lease and lease intended as security are used, but the IRS has issued several revenue rulings describing the distinction between the two.

32 See In Re Parker, 363 B.R. 769, 62 U.C.C. Rep. Serv. 2d 576 (Bankr. D.S.C. 2006).

The second prong of the test pertains to the residual interest under the transaction. It is an economic test that generally provides that if the lessor retains a meaningful value in the leased equipment at the end of the lease term, the transaction is a true lease. In contrast, if the lessor does not retain a meaningful interest, such as when the lessee can acquire the collateral for one dollar or other nominal sum, or when the leased equipment will have little or no value at the end of the term, the transaction will not be deemed a true lease.

In determining whether the transactional documents constitute a true equipment lease or a "lease intended as security," courts generally will not rely upon how the parties styled the documents since the intent of the parties is not relevant,[33] but will instead examine the economics of the transaction.[34] In a nutshell, if the obligor is acquiring equity in the collateral over the course of the transaction the court will generally regard the transaction as a lease intended as security and not a true lease. In contrast, if the obligor is not acquiring equity over the life of the transaction, the court will generally view the transaction as a true lease. The most significant factor weighed by courts in determining whether a transaction is a true lease or a lease intended as security is whether there is a nominal option or other side agreement providing the lessee with the right to acquire the collateral at the conclusion of the term for less than fair market value.[35] But courts may find that a transaction is not a true lease even when the collateral's economic life substantially exceeds the term of the lease and the lessee does not have a nominal purchase option, if the economic realities are such that the lessor is highly unlikely to seek turnover of the collateral at the conclusion of the lease term.[36] This "economic realities" test has become quite popular in recent years.

An option which is really a "PUT" or an obligation of the lessee to buy the leased equipment at the end of the lease, with the lessee obligated to pay any shortfall in the base price and to keep any surplus, will often be held to be a lease intended as a security.[37]

Under Section 1-201(37), the courts may examine other factors including whether the collateral has any meaningful value at the conclusion of the lease term, whether the

---

33 See U.C.C. § 1-203 cmt. 2 ("All of these tests focus on economics, not the intent of the parties.").

34 In contrast, the parties may agree a true lease is a "finance lease" for purposes of Article 2A, which includes special provisions for finance leases. U.C.C. § 2A-103 cmt. (g).

35 See In Re Fleming Cos., Inc., 308 B.R. 693 (Bankr. D. Del. 2004); In Re Sankey, 307 B.R. 674 (D. Alaska 2004); CIT Tech. Fin. Serv., Inc. v. Tricycle Enters., Inc., 13 A.D.3d 783, 787 N.Y.S.2d 133 (N.Y. App. Div. 3d Dep't 2004).

36 See In Re Pillowtex, Inc., 349 F.3d 711 (3d Cir. 2003). The court, holding that the "intent" of the parties was no longer relevant, ruled that courts should consider the costs of removing and repossessing the collateral at the conclusion of the lease. If these costs substantially exceed the value of the collateral, there is no economic incentive to effectuate a repossession.

37 See Cal-Farm Ins. Cos. v. Fireman's Fund Am. Ins. Cos., 25 Cal. App. 3d 1063 (Cal. Ct. App. 1972); Gen. Sec. Ins. Co. v. Reliance Ins. Co., 33 Fed. App'x 310 (9th Cir. 2002).

lease term exhausts the useful life of the collateral and whether the lessee can exercise a nominal extension of the lease for the economic life of the collateral.

Terminal rental adjustment clause (TRAC) leases are hybrid transactions that can be very challenging to classify, especially since they can often be viewed as a PUT.[38] Fortunately for TRAC lessors many states have passed TRAC legislation.[39] Courts are split, however, on interpreting this legislation. Some courts take the view that the legislation requires TRAC leases to be deemed true leases, while others take the position that TRAC statutes only prohibit TRAC leases from being automatically deemed non-true leases, but still require a court to conduct the full true lease analysis.[40]

PRACTICE TIP: It is often difficult to determine with certainty whether a transaction will be deemed a true lease. Accordingly, it is advisable that the practitioner, out of an abundance of caution, comply with Article 9. Article 9 expressly provides that filing a UCC-1 is not an admission that a transaction is secured.[41]

(iii) ***Miscellaneous Exempt Personal Property***: Additional specific personal property excluded from Article 9 includes:

- Wages: An assignment of claim for wages, salary, or other compensation of an employee. U.C.C. § 9-109(d)(3).

Note: This exclusion is limited to wages or other employee compensation. Thus, an independent contractor may create an Article 9 security interest for monies due to the independent contractor.[42]

---

38 But see In Re Rebel Rents, Inc., 291 B.R. 520 (Bankr. C.D. Cal. 2003) (TRAC lease held to be a true lease.); In Re Damron, 275 B.R. 266 (Bankr. E.D. Tenn. 2002) (TRAC lease held to be true lease.).

39 All jurisdictions except Kentucky, New Mexico, and Puerto Rico have enacted some form of TRAC law.

40 Morris v. Dealers Leasing, Inc., (In re Beckham), 275 B.R. 598 (D. Kan. 2002), aff'd In re Beckham, 52 F. App'x 119 (10th Circ. 2002); Hitchin Post Steak Co. v. Gen. Elec. Capital Corp. (In re HP Distribution LLP), 436 B.R. 679 (Bankr. D. Kan. 2010); Morris v. U.S. Bancorp Leasing and Fin. (In re Charles), 278 B.R. 216 (Bankr. D. Kan. 2002) (Kansas TRAC lease statute eliminates argument that TRAC leases are not true leases.). See In re Damron, 275 B.R. at 270. In re Owen, 221 B.R. 56 (Bankr. N.D.N.Y. 1998). See also Lawrence F. Flick, II et al., Leases, 54 BUS. LAW. 1855, 1855-1855-59 (1999) (Surveying cases and authorities on TRAC vehicle leasing).

41 See U.C.C. § 9-505(b).

42 See Mass Mutual Life Ins. Co. v. Cent. Penn Nat'l Bank, 372 F. Supp. 1027 (E.D. Pa. 1974); Perry v. Freeman, 163 Ga. App. 186, 293 S.E.2d 381 (1982).

- Sale of Business: A sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose. U.C.C. § 9-109(d)(4).

- Assignment For Collection Only: An assignment of accounts, chattel paper, payment intangibles, or promissory notes that is for the purpose of collection only. U.C.C. § 9-109(d)(5).

- Performing Party: An assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract. U.C.C. § 9-109(d)(6).

- Limited Assignment in Satisfaction of Debt: An assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness U.C.C. § 9-109(d)(7).

- Insurance Policy Claim Other Than Health Care Receivables: A transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment. U.C.C. § 9-109(d)(8);[43] U.C.C. §§ 9-315 and 9-322 may apply to any insurance as proceeds and priorities in proceeds of other collateral.

---

43 Insurance policies are excluded from Article 9 except for health care receivables and to the extent policies are proceeds of other collateral. U.C.C. § 9-109(d)(8). Western Alliance Bank v. National Union Fire Insurance Company of Pittsburgh, P.A., 88 U.C.C. Rep, Serv 2d 1199 (N.D. Cal. 2016)(secured creditor's lien in personal property did not encompass commercial crime insurance policy, as original collateral or as proceeds). Insurance proceeds for damage or destroyed physical collateral constitutes identifiable cash proceeds. U.C.C. § 9-102(a)(64)(F). Similarly, the damages in a lawsuit to recover for the damage to or destruction of collateral should constitute proceeds. Holms v. Certified Packaging Corp., 551 F. 3d 675, 67 U.C.C. Rep. 2d 684 (7th Cir. 2008). A settlement of such a lawsuit should constitute payment intangibles. See U.C.C. § 9-109. cmt 15. Whether the proceeds of a business interruption policy constitute cash proceeds of a lien in accounts and general intangibles is, however, less clear. See In Re Montreal Maine & Atlantic Railway, Ltd. 521 B.R. 703 (B.A.P. 1st Cir. 2014); but see MNC Commercial Corp. v. Rouse, 1992 WL 674733 (W.D. Mo. Dec. 15, 1992). Where insurance is assigned, outside Article 9, secured party's failure to fully comply with insurance carrier's requirements did not undermine lien perfection where insurance company did not raise the issue. Unum Life Ins. Co. of Am. v. Witt, 83 F. Supp. 3d 687 (W.D. Va. 2015).

PRACTICE TIP: Generally, under non-Article 9 law the secured party must provide an insurance company with an assignment of insurance. Consult the insurance company for its approved form(s). Some states may also require that the secured party take possession of the policy to perfect a security interest. It is advisable that the loan documents include a provision that the secured party may use the insurance monies to pay down the debt even if the debtor is not in default at that time. Also, a secured party may be added to the insurance as a loss payee. If the secured party is not named as a loss payee, it should comply with U.C.C. §§ 9-315 and 9-322 to ensure perfection in proceeds in the hands of debtor. Some states and some insurance policies have notice requirements. It is a best practice for the secured party to send a notice of assignments.

- Judgments: An assignment of a right represented by a judgment, unless the judgment was taken on a right to payment that was collateral, such as an account. U.C.C. § 9-109(d)(9).

PRACTICE TIP: Generally, under the common law the secured party should obtain a written assignment, file it with the court, and if possible, notify the judgment debtor(s).

- Recoupment or Setoff Rights: A right of recoupment or set-off, except:
  - U.C.C. § 9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and
  - U.C.C. § 9-404 applies with respect to defenses or claims of an account debtor. U.C.C. § 9-109(d)(10)(A) and (B).

- Interests in Real Property: The creation or transfer of an interest in a lien on real property,[44] including a lease or rents thereunder, except to the extent that provision is made for:
  - Liens on real property in U.C.C. § 9-203 (automatic attachment in supporting obligations such as an LLC or Guaranty and in

44 A vendor's interest in a land contract may, in some jurisdictions, be deemed to come within the purview of Article 9, and thus, require perfection under Article 9. In Re Northern Acres, Inc. 542 B.R. 641 (Bankr. E.D. Mich. 1985); In Re S.O.A.W. Enterprises, Inc. 32 B.R. 279 (Bankr. W.D. Tex. 1983). But see In Re Blanchard, 819 F. 3d 981 (7th Cir. 2016) (Mortgage alone attached to vendor's interest in land contract without a UCC filing).

supporting liens such as a mortgage) and § 9-308(d) (automatic perfection);

PRACTICE TIP: Two important concepts must be noted in connection with promissory notes and mortgages. First, the mortgage follows the note.[45] Second, because the mortgage follows the note, Article 9 trumps real estate mortgage law regarding priority of liens in mortgages.[46] Thus, where a note and mortgage were double pledged, and creditor A perfected under Article 9 by taking possession of the original note and filing a UCC-1 and creditor B perfected by filing a notice of the assignment of the mortgage in the real property records, creditor A had priority in the note and mortgage.[47] Accordingly, when taking a lien in a note and mortgage, perfection under Article 9 is paramount, even though the mortgage clearly is an interest in real property.

- Fixtures in U.C.C. § 9-334;
- Fixture filings in U.C.C. §§ 9-501, 9-502, 9-516 and 9-519; and
- Security agreements covering personal and real property in U.C.C. §§ 9-604, 9-109(d)(11)(A)–(D).

- Non-Commercial Tort Claim: An assignment of a claim arising in tort, other than a commercial tort claim, except that U.C.C. §§ 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds. U.C.C. § 9-109(d)(12).

Note: When a tort claim settles and becomes a contractual obligation, it is covered by Article 9 as a payment intangible. U.C.C. § 9-102(61).[48]

- Consumer Deposit Accounts: An assignment of a deposit account in a consumer transaction, but U.C.C. §§ 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds. U.C.C. § 9-109(d)(13).

45 See In Re HW Partners, LLC, 2013 WL 4874172 (Bankr. E.D. Wash. Sept. 12, 2013).

46 Id.

47 Id.

48 Non-commercial tort claims are not covered by Article 9. The common law of most states provides that the secured party must obtain a security agreement and, if possible, notify the tortfeasors or defendants to perfect a security interest in a non-commercial tort claim.

Article 9 does not preclude security interests in consumer deposit accounts, but this area is governed by common law.

PRACTICE TIP: Generally, under applicable common law, the secured party should have the debtor assign the account in a written security agreement, the debtor should not have any control or access, and there should be notice to the bank. The bank should also agree that it will not remit any funds to the debtor without the secured party's consent, that it will remit the funds to secured party upon default and request and that it subordinates any security interests or setoff rights it has or may have.

- State As Debtor: Security interests granted by a state or state agency are governed by Article 9 in the absence of a statute providing otherwise. Many states have, however, adopted non-uniform provisions of Article 9, which exclude security interests granted by states or state agencies from Article 9. U.C.C. § 9-109(a)(1). This exemption should be limited to transactions where the state is the debtor, and Article 9 should still apply where the state is the secured party.[49]

(C) Non-Code Legislation

Under U.C.C. § 9-201(b) a state can identify all statutes that continue to apply to Article 9 transactions although Article 9 appears to, or purports to,[50] supersede such statutes. The statutes specified typically apply to small loan accounts, retail and motor vehicle installment accounts and consumer issues, and are not repealed by Article 9. Of course, federal legislation like the Truth-in-Lending Act,[51] Regulations M[52] and Z,[53] and the Fair Debt Collections Act, 15 U.S.C. § 1692 et seq., also apply alongside Article 9.

49 See Delphi Automotive Systems, LLC v. Capital Community Economic/Industrial Dev. Corp., 434 S.W. 3d 481 (Ky. 2014).

50 See Chapter I (E) (ii) (b), infra.

51 See 15 U.S.C. § 1601 et seq.

52 See 12 C.F.R. Part 1013.

53 See 12 C.F.R. Part 226.

Additionally, unless specifically precluded by Article 9, general principals of law and equity still apply, including fraud, misrepresentation, and unconscionability.[54]

(D) Key Terminology

(i) ***Secured Party*** means (a) a person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding; (b) a person that holds an agricultural lien; (c) a consignor; (d) a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold; (e) a trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or (f) a person that holds a security interest arising under U.C.C. §§ 2-401, 2-505, 2-711(3), 2A-508(5), 4-210, or 5-118.[55]

(ii) ***Debtor*** means (a) a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor; (b) a seller of accounts, chattel paper, payment intangibles, or promissory notes; or (c) consignee.[56]

(iii) ***Obligor*** means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.[57]

(iv) ***Secondary Obligor*** means an obligor to the extent that (a) the obligor's obligation is secondary; or (b) the obligor has a right of recourse with

54 See U.C.C. § 1-103. Feresi v. The Livery, LLC, 232 Cal. App. 4th 419, 182 Cal. Rptr. 3d 169 (Cal. App. Ct. 2014).

55 See U.C.C. § 9-102(a)(72).

56 See U.C.C. § 9-102(a)(28).

57 See U.C.C. § 9-102(a)(59).

respect to an obligation secured by collateral against the debtor, another obligor, or property of either.[58]

(v) ***Account Debtor*** means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.[59]

(vi) ***Collateral*** means the property subject to a security interest or agricultural lien. The term includes: (a) proceeds to which a security interest attaches; (b) accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and (c) goods that are the subject of a consignment.[60]

(vii) ***Security Agreement*** means an agreement that creates or provides for a security interest.[61]

(viii) ***Financing Statement*** means a record or records consisting of an initial financing statement and any filed record relating to the initial financing statement.[62]

(ix) ***Authenticate*** means (a) to sign; or (b) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.[63]

(x) ***Communicate*** means (a) to send a written or other tangible record; (b) to transmit a record by any means agreed upon by the persons sending and receiving the record; or (c) in the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.[64]

58 See U.C.C. § 9-102(a)(71).
59 See U.C.C. § 9-102(a)(3).
60 See U.C.C. § 9-102(a)(12).
61 See U.C.C. § 9-102(a)(73).
62 See U.C.C. § 9-102(a)(39).
63 See U.C.C. § 9-102(a)(7).
64 See U.C.C. § 9-102(a)(18).

PRACTICE TIP: Incorporate the definition of "communicate" into standard loan documents. Avoid sending foreclosure notices electronically, especially in consumer cases, although this process is approved in the 2010 Amendments to Article 9 ("the 2010 Amendments"). [65]

Note: Under Article 9 the debtor and obligor are not necessarily the same person. This distinction can significantly affect issues of attachment, default and foreclosure.

Note: The definitions of "authenticate" and "communicate" provide for electronic acceptance or acknowledgement of a record in lieu of a personal signature and for electronic transmission or communication.

(E) Important Basic Concepts

(i) *General*

(a) Good Faith: The UCC requires "honesty in fact and the observance of reasonable commercial standards of fair dealing."[66] This requirement applies to Article 9 transactions and appears throughout the U.C.C. generously.

(b) Official Comments: The Official Comments to Article 9 do not have the probative value of legislative history since many legislators may not have reviewed the Official Comments when they considered Article 9, especially when states have adopted non-uniform sections. Some states, however, may have included legislative committee comments. These comments should be treated like any other legislative history.

---

65 The 2010 Amendments became effective July 1, 2013, for most states. Oklahoma is the only state which has yet to adopt the 2010 Amendments. Under the transition rules, the 2010 Amendments will apply to transactions entered into prior to the effective date, except that they will not affect any action, case or proceeding commenced prior to the effective date. U.C.C § 9-802 (a) and (b). Under the grandfather provisions, however, a security interest properly perfected under the prior law, which does not comply with the new law, shall remain perfected for one year after the effective date. U.C.C. § 9-803(b). But where the prior perfection was achieved through filing a financing statement and was good under the old law, but is not in compliance with the new law, such financing statement will be valid until it expires or June 30, 2018, whichever is earlier. U.C.C. § 9-805(b). If the defect under the new law is the name of the debtor, the secured party may correct same when it files a continuation statement. Notably, New York did not adopt the transition rules.

66 See U.C.C. § 9-102(a)(43). This is the standard throughout the U.C.C. with the exception of Article 5.

(ii) *Free Alienability*

(a) Purported Reservations of Title By Seller: One of the primary goals of Article 9 is to encourage the pledge, securitization and transfer of secured debt. Accordingly, Article 9 takes specific aim at contractual provisions and laws that attempt to limit the granting of security interests in or the sale or transfer of secured transactions.[67]

Consistent with this policy, an attempt by a seller in an installment sale document to retain title until paid in full is unenforceable and is instead deemed to be only a reservation of a security interest.[68]

(b) U.C.C. §§ Sections 9-401, 9-406 and 9-408: Limits on Restrictions That Might Otherwise Impede Article 9.

(1) U.C.C. § 9-401(b) provides as follows:

- Agreement Does Not Prevent Transfer – An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.

- This section makes abundantly clear that the debtor's interest in the collateral may be disposed of or reached by other creditors, despite a contractual provision purporting to preclude a transfer. Unlike §§ 9-406 and 9-408 discussed below, § 9-401(b) does not preclude a clause that makes the grant of a lien or transfer an event of default, it only precludes contractual provisions that invalidate the pledge or sale.

(2) U.C.C. § 9-406(d) deals with accounts (except health care insurance receivables) and chattel paper, whether pledged as collateral or sold, and with payment intangibles and promissory notes, to

67 A secured party may not, however, transfer a security interest without also transferring the debt or indebtedness. The security interest follows the debt. See Rentenbach Constructors, Inc. v. CM P'ship, 181 N.C. App. 268, 639 S.E.2d 16 (N.C. Ct. App. 2007).

68 See U.C.C. §§ 1-201(b)(37) and 2-401; In Re Clean Burn Fuels, LLC, 492 B.R. 445, 454 (Bankr. M.D.N.C. 2013).

the extent that they are pledged as collateral, but are not the subject of sales. Section 9-406(d) invalidates contractual provisions that restrict or limit liens or sales (on accounts and chattel paper only) by prohibiting them, requiring consent, or that classify them as defaults under the agreement.

(3) U.C.C. § 9-406(f) does for laws that restrict or limit liens or sale the same thing as U.C.C. § 9-406(d) does for contractual provisions, except that U.C.C. § 9-406(f) is limited to accounts and chattel paper and excludes leased goods. U.C.C. §§ 2A-303 and 9-407.[69]

(4) U.C.C. § 9-408(a) applies to contract provisions relating to health care receivables and general intangibles, pledged as collateral or sold, and to sales of promissory notes and payment intangibles.[70] U.C.C. § 9-408 provides that it includes, but is not limited to, a "contract, permit, license or franchise." U.C.C. § 408(c) applies to laws relating to health care receivables, promissory notes and general intangibles, pledged as collateral or sold. Like § 9-406, § 9-408 prohibits contractual provisions and laws that limit the creation, attachment or perfection of the security interest or sale or that characterize the transfer as a default or breach. U.C.C. § 9-408(a) and (c).[71]

Section 9-408 deals with enforcement issues very differently, however, from § 9-406. Generally, § 9-408 does not interfere with an otherwise

69 See Forman v. Carver Fed. Sav. Bank, 2012 WL 6150631 (Bankr. D.N.J. Dec. 11, 2012) (New Jersey state law restricting solid waste collector's ability to grant a security interest in its assets is superseded by Article 9); Clark v. Missouri Lottery Commission, 86 U.C.C. Rep.2d 967 (Mo. Ct. App. 2015) Tex. Lottery Comm'n v. First State Bank of DeQueen, 254 S.W.3d 677 (Tex. App. 2008) (court allowed lottery winner to sell right to installment payments despite state law barring sale). Note, however, the Texas legislature in 2014 amended 9-406(f) to preclude assignments of lottery prizes. Federal and state statutes specifically intended to survive Article 9, however, override Article 9. U.C.C. § 9-109(c). But see Stone Street Capital, LLC v. Cal. State Lottery Comm'n, 80 Cal. Rptr. 3d 326, (Cal. Ct. App. 2008); Wolf v. Brach, 660 N.Y.S. 2d 430 (1997) (court denied lottery winner right to sell installment payments). Most states have enacted special statutes governing assignment of lottery prizes, usually requiring a court order for any assignment. Finally it should be noted that Revised Article 9 incorporates lottery winnings into the definition of accounts. Thus, any pledge or assignment of lottery prizes should be accompanied with a UCC-1 filing.

70 See U.C.C. § 9-408(a) and (b).

71 See In Re Pacific/West Commc'n Grp., Inc., 301 F.3d 1150 (9th Cir. 2002); 321 Henderson Receivables Origination LLC v. Sioteco, 93 Cal.Rptr.3d 321 (Cal. Ct. App. 2009); see also Forman, supra.

effective restriction (in contract or under law) on the secured party's or buyer's ability to enforce its security interest or purchased interest. Under § 9-408(d), any security interest created under § 9-408(a) and (e) despite a contractual provision or law otherwise, will have very limited enforceability as a security interest. § 9-408(d) provides:

To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a rule of law, statute, or regulation described in subsection (c) would be effective under law other than this article but is ineffective under subsection (a) or (c), the creation, attachment, or perfection of a security interest in the promissory note, health-care-insurance receivable, or general intangible:

1. Is not enforceable against the person obligated on the promissory note or the account debtor;
2. Does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;
3. Does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment of performance from the secured party;
4. Does not entitle the secured party to use or assign the debtor's rights under the promissory note, health-care-insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health-care-insurance receivable, or general intangible;
5. Does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and
6. Does not entitle the secured party to enforce the security interest in the promissory note, health-care-insurance receivable or general intangible.[72]

Section 9-408 often comes into play with licenses, such as software and liquor licenses. In such cases, a contract provision or law prohibiting

72 See U.C.C. § 9-408(d).

the licensee from pledging the license as collateral is not enforceable, but the secured party may not enforce the security interest without the permission of the owner.

Note: Section 9-409 has similar provisions for Letters of Credit.

Note: Section 9-406 governs pledges of promissory notes and payment intangibles and § 9-408 applies to sales of this collateral. Thus, in the event of sales of promissory notes and payment intangibles, an account debtor or maker does not have to recognize the buyer. The 2010 Amendments clarify that a sale or other disposition of collateral under § 9-610 (secured party's sale) or under § 9-620 (acceptance of collateral by secured party in satisfaction of debt) is governed by § 9-406 and not § 9-408.

Note: (1) United States' receivables: The secured party may perfect its lien under Article 9, but may not collect directly from the federal government unless it complies with the Assignment of Claims Act of 1940.[73] Compliance is a difficult process, and even if the secured party does comply, the government retains all rights of setoff and recoupment. Unless there has been compliance by the secured party, the government has no obligation to pay the secured party. However, the secured party is perfected in the receivables.[74] (2) Pick Your Partner laws: The free alienability provisions generally do not conflict with the various state "pick your partner" laws and provisions. The free alienability provisions are designed to permit free alienability of economic rights, not governance rights. Moreover, an ownership interest in an LLC is a general intangible and Article 9 does not apply to the sale of general intangibles, but only to the sale of payment intangibles. Nevertheless, some states, such as Delaware and Virginia, have enacted provisions that make § 9-406 and § 9-408 alienability restrictions inapplicable on ownership and governance rights of partnerships and limited liability companies.

(iii) *Limits on Liability*

(a) Secured Party Has No Liability to Third Parties:

Consistent with Article 9's policy of encouraging transactions, U.C.C. § 9-402 provides that a secured party will not be liable to third

73 See 31 U.S.C. § 3727 (2012); 41 U.S.C. § 15 (2012).

74 See U.C.C. § 9-315.

parties for the debtor's acts or omissions, whether the claims sound in contract or tort.[75] This section applies to agricultural liens as well.

(b) Waiver of Defenses by Account Holders:

Again, consistent with Article 9's policy of facilitating the sale and assignment of secured transactions, U.C.C. § 9-403 provides that an account debtor may waive and agree not to assert against any assignee any defenses that the account debtor may have against the original secured party or assignor. This provision is only applicable, however, when the assignee takes the assignment:

(1) For value; in good faith; without notice of a claim of a property or possessory right to the property assigned; and without notice of a claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under section 3-305(b).[76]

This provision parallels the holder in due course doctrine of Article 3. Defenses that are permissible against a holder in due course under § 3-305(b) continue to apply.[77] The ambit of § 9-403 is limited to non-consumer transactions. Legislation that provides that an account debtor may assert defenses against an assignee in consumer transactions continues to apply. For example, the FTC's Holder In Due Course Regulations, 16 C.F.R. §§ 433.1-433.3, provide that consumer credit contracts must include a legend preserving consumer claims and defenses; this provision is deemed applicable even if the legend is not included, and the account debtor may assert claims and

75 See Brandes v. Pettibone Corp., 79 Misc. 2d 651, 360 N.Y.S.2d 814 (N.Y. Sup. Ct. 1974).

76 See U.C.C. § 9-403(b). This section only applies to account debtors as defined in U.C.C. § 9-102. Thus, it does not address whether a person obligated on a negotiable instrument may raise defenses and claims, a topic governed by Article 3. Indeed, Article 3 governs even when the negotiable instrument constitutes part of chattel paper. See U.C.C. § 9-102 (an obligor on a negotiable instrument constituting part of chattel paper is not an "account debtor"). See also U.C.C. § 9-403 cmt. 2. While section 9-403 (b) refers to "an account debtor and an assignor" the agreement may also be between the debtor and the assignee where the circumstances are consistent with common law estoppel. Sterling Commercial Credit-Michigan LLC v. Hammert's Iron Works, Inc. 998 N.E. 2d 752 (Ind. Ct. App. 2013). See also, Footnote 79, infra.

77 See U.C.C. § 9-403(c).

defenses.[78] Indeed, to the extent any law provides that an account debtor in a consumer transaction may assert all defenses and claims against an assignee, that law trumps § 9-403.[79]

(c) Limits of Claims Against Assignees by Account Debtors:

Unless waived by the account debtor as provided in § 9-403 above, an account debtor may assert all claims and defenses against an assignee.[80] The assignee takes subject to all claims and defenses, whether they arose before or after the assignment, if the claims or defenses "arise from the transaction that gave rise to the contract," which include claims sounding in recoupment.[81] The assignee does not, however, take subject to other claims or defenses such as setoff claims, unless they arose before the assignment.[82] These claims, however, whether they be in the nature of recoupment, setoff or other-

78 See U.C.C. § 9-403(d)(1), (2). The FTC regulations apply to "financed sales" and "purchase money loans." 16 C.F.R. § 433.1(d), (e), (i). Thus, if the secured transaction is financed by a non-seller under a note and security agreement, this provision may not apply, although it was probably intended to do so.

79 See U.C.C. § 9-403(e). Note this provision includes not only statutes, but also "administrative rules and regulations." See U.C.C. § 9-403 cmt. 6. This provision, however, does not displace other law that upholds waivers such as "hell or high water" provisions or claims of estoppel. U.C.C. § 9-403(f). See U.C.C. § 9-403 cmt. 6. An account debtor's assurances to a factor may give rise to an estoppel claim. Quantum Corporate Funding Ltd. V. L.P.G. Associates, Inc., 246 A.D.2d 320 (N.Y. App. Div. 1998); Dimmitt & Owens Financial, Inc. v. Realtek Industries, 280 N.W.2d 827, 27 U.C.C. Rep. 302 (Mich. Ct. App. 1979).

80 See U.C.C. §§ 9-404(a), 9-404(a)(1). Accounts which arise as proceeds of the sale of inventory are covered by § 9-404 as if they were original collateral. For a discussion of when the other claim arose, or accrued, See Seattle-First Nat'l Bank v. Or. Pac. Indus., Inc., 500 P.2d 1033 (Or. 1972) and Investment Service Co. v. North Pacific Lumber Co., 492 P.2d 470 (Or. 1972). The debtor may not, however, generally assert common law tort theories. U.C.C. § 1-103. Tort theories are also generally barred by the economic loss doctrine. Ulbrich v. Groth, 310 Conn. 375 (Conn. 2013). The account debtor may also not assert its setoff rights against a secured party's replevin action where the collateral is grain and proceeds and the secured party complied with not only Article 9, but also the Federal Food Security Act, 7 U.S.C. §163 (e) (2). Indeed, an ordinary course buyer may not be able to assert recoupment or setoff at all where the secured party complied with the Food Security Act. Farm Credit Servs. of Am. v. Cargill, 2013 WL 12075565 (D. Neb. March 27, 2013).

81 See U.C.C. § 9-404 cmt. 2. See also Riviera Fin. of Tex., Inc. v. Capgemini US, LLC, 511 Fed. App'x 92, 93-94 (2d Cir. 2013). Note that whether the account debtor has a valid claim that may be the subject of a recoupment or setoff will generally be determined by state law. Id.

82 See U.C.C. § 9-404(a)(2). Thus, the account debtor has maximum rights where there is one single contract, as opposed to where there are multiple consecutive contracts.

wise, may only be asserted to "reduce the amount the account debtor owes."[83] These claims also are limited to monetary offsets, and may not be employed to defeat a replevin action.[84] Thus, the assignee's maximum exposure is loss of the right to collect the debt; the account debtor does not have the right to an affirmative recovery from an assignee.[85]

Once again, this provision is limited to "non-consumer" transactions.[86] Because the payor of health care insurance receivables is an insurance company, this section also does not apply to health care insurance receivables.[87] Finally, as noted in Official Comment 5 to § 9-404, the rights (and limitations) of an account debtor under § 9-404 do not apply in a few other cases:

"Neither this section nor any other provision of this Article, including Sections 9-408 and 9-409, provides analogous regulation of the rights and duties of other obligors on collateral, such as the maker of a negotiable instrument (governed by Article 3), the issuer of or nominated person under a letter of credit (governed by Article 5), or the issuer of a security (governed by Article 8). Article 9 leaves those rights and duties untouched; however, Section 9-409 deals with the special case of letters of credit. When chattel paper is composed in part of a negotiable instrument, the obligor on the instrument is not an "account debtor," and Article 3 governs the rights of the assignee of the chattel paper with respect to the issues that this section addresses.

83 See U.C.C. § 9-404(b). An account debtor's right of setoff also does not apply to defeat a replevin action. Farm Credit Services of America PCA v. Caugill, Inc., 750 F. 3d 965 (8th Cir. 2014).

84 See id. (While account debtor may have been able to declare an offset against a monetary claim against it, the account debtor could not defeat a replevin action by a superior creditor by declaring an offset.

85 See U.C.C. § 9-404(b). See also U.C.C. § 9-404 cmt. 3; Riviera Finance of Texas, Inc. v. Capgemini, US, LLC, supra.

86 See U.C.C. § 9-404(c).

87 See U.C.C. § 9-404(e).

> See, e.g., U.C.C. § 3-601 (dealing with the discharge of an obligation to pay a negotiable instrument)."[88]

Thus, in the case of negotiable instruments, including negotiable instruments as a part of chattel paper, §§ 9-403, 9-404, 9-406 and 9-408 do not apply. The term "account debtors," and thus the 9-404 rules, also do not apply to an assignment of heath care receivables, and to banks with regard to their rights in deposit accounts.

88 See U.C.C. § 9-404 cmt. 5 (emphasis added). Under Revised Article 9 commercial tort claims, deposit accounts, and letter-of-credit rights were excluded from the definition of general intangibles. One important consequence of this exclusion is that tortfeasors (commercial tort claims), banks (deposit accounts), and persons obligated on letters of credit (letter-of-credit rights) are not "account debtors" having the rights and obligations set forth in Sections 9-404, 9-405 and 9-406. In particular, tortfeasors, banks, and persons obligated on letters of credit are not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-406(a). See U.C.C. § 9-404 cmt. 5(h).

II

CREATING A SECURITY INTEREST AND THE SCOPE OF A SECURITY INTEREST

(A) Attachment

"A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment."[89]

A security interest in a supporting obligation automatically attaches upon attachment to the supported obligation.[90]

A security agreement is generally enforceable against the debtor and third parties only when:

(1) Value is given;
(2) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and
(3) One or more of the following conditions is met:

---

89 See U.C.C. § 9-203(a). Pursuant to U.C.C. § 9-203(a) attachment may be postponed if the agreement so provides. Absent a compelling reason, it is not advisable to delay attachment because if the debtor files for bankruptcy before attachment occurs, the putative secured party is unsecured. The agreement must expressly state that a putative secured party is willing to delay attachment.

90 See U.C.C. § 9-203(f).

- The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;
- The collateral is not a certificated security in registered form and is in the possession of the secured party under § 9-313 pursuant to the debtor's security agreement;
- The collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under § 8-301 pursuant to the debtor's security agreement; or
- The collateral is deposit accounts, electronic chattel paper, investment property, or letter of credit rights, and the secured party has control under §§ 9-104, 9-105, 9-106, or 9-107 pursuant to the debtor's security agreement. [91]

(i) ***Value***

The "value" required is minimal. Indeed, an unfilled promise to pay may suffice.[92] Value also does not require new consideration,[93] but Article 9 does not, however, protect a transfer from attack as a bankruptcy preference, fraudulent conveyance or other similar claim.[94]

(ii) ***Debtor Has Rights In the Collateral***

Although Article 9 does not define "rights in the collateral" case law illuminates.[95] Title is not required.[96] A debtor's rights under a sale[97] or lease[98] or

91 See U.C.C. § 9-203(b). Under U.C.C. § 9-203(b)(3)(B), (C) and (D), a secured party with possession of securities or control does not need to enter a security agreement. However, it is generally advisable to do so.

92 See Ohio Graphco, Inc. v. RCA Capital Corp., 2009 WL 3739460 (W.D. Ky. Nov. 6, 2009).

93 See U.C.C. § 1-201(44)(b). See also Bank of Lexington v. Jack Adams Aircraft Sales, Inc., 570 F.2d 1220 (5th Cir 1978).

94 See Bankruptcy and Fraudulent Transfers section, infra.

95 See generally Michael B. Thompson, Those Calves are Mine: Toward Uniform Commercial Code Definition of "Rights in the Collateral," 53 S.D. L. REV. 74 (2008).

96 See Franklin Bank v. Tindall, 2008 WL 937488 (E.D. Mich. Apr. 7, 2008).

97 See, e.g., In Re Pelletier, 1968 WL 9235 (Bankr. D. Me. May 3, 1968). See also General Motors Acceptance Corp. v. Wash. Trust Co., 120 R.I. 197, 386 A.2d 1096 (R.I. 1978).

98 See Franklin Bank, 66 U.C.C. Rep. Serv. 2d 133. See also Karp Bros., Inc. v. West Ward Sav. & Loan Ass'n, 440 Pa. 583, 271 A.2d 493 (Pa. 1970).

consignment[99] have all been held to be sufficient, but an unexercised option to buy goods was held to be insufficient to give rights in the collateral,[100] and a broker was held not to have rights in goods offered for sale.[101]

Possession alone is not enough.[102] Indeed, despite possession, an oral trust arrangement may not only remove property from a debtor's bankruptcy estate, but it may also defeat the claims of secured creditors.[103] Possession is not, however, necessary if other significant rights in the collateral exist.[104] Possession with contingent rights of ownership[105] or voidable title[106] have been upheld.[107]

A partner or LLC member may not have a sufficient interest in partnership or LLC assets to pledge them for a personal debt.[108] Conversely, a corporation or limited liability company has no interest in an asset owned by its shareholders or members.[109] If, however, the non-debtor partner/shareholder/company who/which owns the collateral consents to the pledge, the debtor is likely to be held to have sufficient "rights in the

99 See, e.g., Harker v. Dauphin Deposit Bank & Trust Co. (In Re E.G. Hoover Co., Inc.), 16 B.R. 435 (Bankr. M.D. Pa. 1982). A consignee does not have to have "rights in the collateral" to grant a subsequent "security interest". See also U.C.C. §§ 9-203(b)(2), 9-318, 9-319.

100 See Jerke Constr., Inc. v. Home Fed. Sav. Bank, 693 N.W.2d 59 (S.D. 2005); State Bank of Young Am. v. Wagener, 479 N.W.2d 92 (Minn. Ct. App. 1992).

101 See A. Lassberg & Co. v. Atl. Cotton Co., 291 S.C. 161, 352 S.E.2d 501 (S.C. 1986).

102 See Jerke Constr., Inc. v. Home Fed. Sav. Bank, 2005 SD 19, 693 N.W.2d 59 (S.D. 2005).

103 See Oxford St. Props., LLC v. Rehabilitation Assocs., LLC, 141 Cal. Rptr. 3d 704 (Cal. Ct. App. 2012) (money in debtor's bank account not subject to lender's security interest).

104 See Kunkel v. Sprague Nat'l Bank, 128 F.3d 636 (8th Cir. 1997).

105 See K.N.C. Wholesale, Inc. v. AWMCO, Inc., 56 Cal. App. 3d 315, 128 Cal. Rptr. 345 (Cal. Ct. App. 1976); Trust Co. Bank v. Gloucester Corp., 419 Mass. 48, 643 N.E. 2d 16 (Mass. 1994).

106 See Beebe v. MacMillan Petroleum (Ark.), Inc. (In Re MacMillan Petroleum (Ark.), Inc.), 115 B.R. 175 (W.D. Ark. 1990); Foley v. Prod. Credit Ass'n, 753 S.W.2d 876 (Ky. Ct. App. 1988); First-Citizens Bank & Trust Co. v. Academic Archives, Inc., 10 N.C. App. 619, 179 S.E.2d 850 (N.C. Ct. App. 1971).

107 It has been held that a debtor has no rights in crops until planted. Siemers v. AG Servs., Inc. (In Re Siemers), 249 B.R. 205 (Bankr. D. Neb. 2000).

108 See Peoples Bank v. Bryan Bros. Cattle Co., 504 F.3d 549, 554 (5th Cir. 2007); Magill v. Schwartz, 197 Or. App. 334, 105 P.3d 867 (Or. Ct. App. 2005).

109 See Lebedowicz v. Meserole Factory, LLC, 33 Misc. 3d 1236(A), 941 N.Y.S.2d 538 (N.Y. Sup. Ct. 2011); Gasser v. Infanti Int'l, Inc., 353 F. Supp. 2d 342 (E.D.N.Y. 2005); Rice v. Fas Fax Corp. (In Re Hot Shots Burgers & Fries, Inc.), 169 B.R. 920 (Bankr. E.D. Ark. 1994).

collateral."[110] Similarly, a debtor may be estopped from denying it has rights in collateral where it specifically represented, in writing, such rights or where she has allowed another to appear as the owner.[111]

A secured party may be on "inquiry notice" if it has reason to be suspicious, in that it can't close its eyes and take a lien in collateral it knows, or should know, the debtor did not own or could not pledge.[112]

Finally, while a consignee does not have any ownership rights in consigned goods, because Article 9 requires a UCC-1 to be filed by the consignor, if a UCC-1 is not filed, a perfected secured party in the inventory of the consignee may trump the consignor, despite the consignee's apparent lack of "rights in the collateral".[113]

PRACTICE TIP: A secured party should thoroughly investigate a debtor's right to the collateral, including reviewing bills of sale and chain of title documents and inspection of tangible collateral.

(iii) ***An Authenticated Security Agreement***

Under § 9-203(b)(3)(B), (C) and (D) above, if securities collateral is in the possession of the secured party or the secured party has control of the collateral in the case of a deposit account, electronic chattel paper, investment property or a letter of credit, a written and authenticated security agreement is not required.[114] Possession alone does not, however, imply an oral agreement for a security interest, and the intent of the

110 See In Re WL Homes, 534 Fed. App'x 165 (3d Cir. 2013) (parent corporation granted lien in wholly owned subsidiary's assets); In Re Terrabon, Inc., 2013 WL 6157980 (Bankr. S.D. Tex. Nov. 22, 2013) (ownership of collateral not required, consent or estoppel of owner sufficient); In Re Whatley, 874 F.2d 997 (5th Cir. 1989) (shareholder who owned collateral executed corporate documents for debtor's pledge); Merchants Bank v. Atchison (In Re Atchison), 832 F.2d 1236 (11th Cir. 1987) (shareholder who owned collateral pledged for his corporation held to have consented to granting security interest); In Re Pubs, Inc. of Champaign, 618 F.2d 432 (7th Cir. 1980) (two individuals who were owners of corporation pledged their own equipment as collateral for company, held to have consented to pledge).

111 See Wells Fargo Bank Minn., N.A. v. Robex, Inc., 711 N.W.2d 732 (Iowa Ct. App. 2006) (owner represented such rights in writing); MBK Serv., Inc. v. Cole Taylor Bank, 2013 IL App (1st) 123026-U (Ill. App. Ct. 2013) (owner allowed another to appear as the owner).

112 See Grede v. Bank of N.Y. Melon Corp. (In Re Sentinel Mgmt. Grp.), 809 F.3d 958 (7th Cir. 2016) ("inquiry notice" is not actual knowledge of fraud... but merely knowledge that would lead a reasonable law abiding person to inquire further – would make him in other words suspicious enough to conduct a diligent search for possible dirt.")

113 See U.C.C. § 9-103(d).

114 See U.C.C. § 9-203(b)(3)(B), (C) and (D). It is, nevertheless, advisable that the secured party obtain a written security agreement.

parties to create a security agreement must be clear.[115] The burden of proof is on the proponent; it must prove that both parties harbored a definite intent to create a security interest and that exclusive possession of the collateral passed to the creditor contemporaneous with the oral agreement.[116]

If an authenticated security agreement is required, the secured party must have one or its security interest will not be enforceable against the debtor. The requirement is in the nature of a statute of frauds.[117] A security agreement does not need to be entitled "security agreement."[118] A Sears' sales check signed by a customer was held to be a security agreement where the sales check included the following language, "I grant Sears a security interest or lien in this merchandise unless prohibited by law, until finally paid."[119]

A security agreement also need not be one agreement. Where a debtor executed a Purchase Agreement and a Servicing Agreement and the Purchase Agreement did not include any granting language but the Service Agreement did, the secured party was held to have an authenticated security agreement.[120] Under the composite doctrine,[121] two or more documents can together satisfy the requirement for an authenticated security agreement. This doctrine was more likely to be invoked under Article 9 before the 1999 revisions, when the UCC-1 had to be signed by the debtor. A secured party might then have coupled a promissory note and the debtor-executed UCC-1 to meet the authenticated security agreement requirement. Now that the UCC-1 is not required to be executed by the debtor, the secured party is less likely to have an authenticated document to satisfy the security agreement requirement if it does not obtain an authenticated security agreement. In the case of titled vehicles, the secured party may still be able to rely upon the motor vehicle title documents to satisfy the requirement for an authenticated security agreement, if it requires the debtor to execute the title documents.

115 See U.C.C. § 9-102(a)(7).

116 See In Re Boca Arena, Inc., 237 B.R. 221, 223-24 (Bankr. S.D. Fla. 1999) (quoting Rubin v. Reorganized Church (In Re Chuning), 70 B.R. 98 (W.D. Mo. 1987)).

117 See U.C.C. § 9-203 cmt. 3.

118 See, e.g., Frace v. Canal Nat'l Bank (In Re Frace), 17 B.R. 198 (Bankr. D. Me. 1982).

119 See In Re Hance, 181 B.R. 184 (Bankr. M.D. Pa. 1993).

120 See MTGLQ Investors, LP v. Bresco Solutions, LLC (In Re Marble Cliff Crossing Apartments, LLC), 484 B.R. 175 (Bankr. S.D. Ohio 2012).

121 See In Re Numeric Corp., 485 F.2d 1328 (1st Cir. 1973). A few jurisdictions, such as Wisconsin, have not adopted the composite doctrine. Barth Bros. v. Billings, 68 Wis. 2d 80, 227 N.W.2d 673 (Wis. 1975).

Most courts hold, and many commentators agree, that a security agreement does not require any magic words to create a security interest.[122] Even a grant of a security in the future tense will suffice where the equipment was not yet installed.[123] Whether a transaction created a security interest, absent express language, depends on the intent of the parties, which may be a question of fact or a mixed question of fact and law.[124] A minority of courts, however, hold that a security agreement requires an express grant of a security interest.[125] This minority position can become an issue when a lease includes a nominal purchase option or otherwise is deemed to be a lease intended as security under U.C.C. § 1-203(37). In such a case the lease may not include any "granting language" as it was drafted to document a lease, not a secured transaction. Because § 1-203(37) deems such a lease to be a "lease intended as security" a strong argument can be made that the requirement for a security agreement, including granting language, is deemed satisfied. It is, however, recommended that the practitioner include in any lease a provision that states that if the lease is deemed to be a lease intended as security the lessee grants the lessor a security interest in the leased equipment as collateral.

All states have a motor vehicle certificate of title act. These acts generally provide that the lien must be perfected by documenting the lien on the title, but do not address how to create the security interest. Accordingly, Article 9 generally governs the creation of the security interest, even in titled motor vehicles, and thus, the secured party must have an authenticated security agreement for the lien to "attach."

As noted above, "consignments" were brought within the scope of Article 9 under the 1999 revisions. Article 9, however, treats true consignments and consignments intended as security differently. While true consignments[126] are subject to the filing requirements of Article 9, they are not required to be reflected in a security agreement.

---

122 See In Re Flager, 2007 WL 1701812 (Bankr. M.D. Ga. 2007). See, e.g., Grant Gilmore, Security Interests in Personal Property § 11.4 at 347-348 (1965); Harold R. Weinberg, Toward Maximum Facilitation of Intent to Create Enforceable Article 9 Security Interest, 18 B.C. L. REV. 1 (Nov. 1976).

123 See In Re Marble Cliff Crossing Apartments, LLC,484 B.R. 175 (Bankr. S.D. Ohio 2012). See also, In Re Saxe, 491 B.R. 244, 247 (Bankr. W.D. Wisc. 2013) (security agreement which included "1 skidsteer to be purchased" upheld).

124 See In Re Inofin, Inc., 455 B.R. 19 (Bankr. D. Mass. 2011).

125 See, e.g., In Re Martronics, Inc., 1964 WL 8567 (Bankr. D. Conn. Nov. 30, 1964).

126 See U.C.C. § 9-102(20). There are three categories of consignments that are exempt from Article 9: (1) the goods are delivered to a merchant generally known by its creditors to be substantially engaged in selling the goods of others; (2) with respect to each delivery, the aggregate value of the goods is less than $1000 at the time of delivery; and (3) the goods are consumer goods immediately before delivery.

In contrast, consignments intended as security are fully incorporated into Article 9 and must satisfy the security agreement and the filing requirements.

If title to the collateral is held jointly, the secured party should have both parties authenticate the security agreement and authorize the filing of financing statements, and the financing statements should be filed against both parties. In this scenario, the secured party should beware of the Equal Credit Opportunity Act ("ECOA")[127] and the security agreement should clearly provide there is no recourse against the joint debtor unless there is a proper basis for recourse under the ECOA.

PRACTICE TIP: Because it is often difficult to say with certainty whether a consignment is a true consignment or a consignment intended as security, it is advisable to obtain a written security agreement and to meet the Article 9 filing requirements, especially since it is the consignor's burden to prove that the transaction is a true consignment and that Article 9 does not apply.[128]

PRACTICE TIP: In the case of multiple lenders, where one secured party is acting in a representative capacity for the group the security interest should be granted in favor of the representative for the benefit of the lenders' group.

(a) Adequacy Of Collateral Description In Security Agreement

As noted above, when the collateral is securities in the possession of the secured party or the secured party has obtained control under §§ 9-104, 9-105, 9-106 or 9-107, a written security agreement is not required.[129] In all other cases, there must be a written security agreement describing the collateral. The "description" of the collateral is only sufficient if it "reasonably identifies" the collateral.[130] More specifically, the description of the collateral is sufficient if it identifies the collateral by:

- specific listing;
- category;
- a type of collateral defined in the U.C.C.;

127 See 15 U.S.C. § 1691 et seq. (2012).

128 See In Re Downey Creations, LLC, 414 B.R. 463 (Bankr. S.D. Ind. 2009).

129 See U.C.C. § 9-203(b)(3)(B)-(D).

130 See U.C.C. § 9-108(a). The 1999 revisions of Article 9 did not alter this standard, and decisions that predate the revisions should still apply. Revised Article 9, however, as noted below, creates some safe harbors.

- quantity;
- computational or allocational formula or procedure; or any other method, if the identity of the collateral is objectively determinable, except for the use of a supergeneric description such as "all assets" or "all personal property."[131]

Notably, the drafters of the 1999 revisions to Article 9 rejected any requirement for serial numbers. The drafters also created a safe harbor when using "types" as defined in the U.C.C. Use of a type that includes sub-types will automatically include the sub-types, but the reverse is not true. Thus, if the collateral description is "accounts," it will automatically include health care insurance receivables. Conversely, if the collateral description is health care insurance receivables, it will not automatically include accounts. The exceptions to the "types" safe harbor are commercial tort claims and consumer transactions when the collateral is goods or investment property, namely, a security entitlement, a securities account or a commodity account, all of which must be identified with specificity.[132] In other words, with goods and investment property, description by type is only adequate for non-consumer transactions, and a description by type is never adequate for commercial tort claims.[133] Finally, if the security interest covers timber to be cut, the security agreement must include a description of the land.[134]

A "supergeneric" description of collateral such as "all assets" or "all personal property" is not sufficient for purposes of describing the collateral in a security agreement:[135] a supergeneric description of collateral is only acceptable in a financing statement.[136] A collateral description will, however, generally be acceptable in a security agreement where it is defined as all goods purchased from a seller or all

131 See U.C.C. § 9-108(b), (c).

132 See U.C.C. § 9-108(b), (b)(3) and (e). Commercial tort claims also may not be the subject of an after acquired clause, but may constitute proceeds of other collateral. U.C.C. §§ 9-204(b)(2), 9-102(a)(64)(D), 9-203(F) and 9-315(d)(1). Thus, a secured party with a lien on specific collateral but without a lien on a commercial tort claim, may still have a lien on the monies obtained through the commercial tort claim where same were for damage to the collateral. Helms v. Certified Packaging Corp., 551 F.3d 675 (7th Cir. 2008). But such a secured party will not have a claim to the settlement proceeds of such a commercial tort claim to the extent the settlement monies are not related to damage to the specific collateral, but rather for damage to real property or lost business opportunity. Id.

133 See U.C.C. § 9-108(e).

134 See U.C.C. § 9-203(b)(3)(A).

135 See U.C.C. § 9-108(c).

136 See U.C.C. § 9-504(2).

goods purchased with the secured party's loan proceeds.[137] The difference between what is required for the collateral description in a security agreement versus a financing statement arises from the different purposes of the documents. The security agreement memorializes the parties' agreement. The financing statement is only intended to put others on notice of the lien.[138]

An error in the description of the collateral may invalidate the security agreement. Generally, however, the courts distinguish between minor errors and major errors in a security agreement. Minor errors do not impair the ability to identify the collateral.[139] Significantly, however, a security agreement attaches only to the property described in the security agreement.[140]

Because the collateral description only needs to be "objectively determinable" it may cross reference to another document.[141] Indeed, the description may even be sufficient where it is merely described as "all goods...purchased under this Plan... either now or in the Future" where it can be reasonably determined what good, where purchased under the plan.[142]

Finally, the creditor should not describe the collateral by its location, so much as by its type and specific description. Generally, describing the collateral as the items at a certain location will not suffice, as such a description is not dependable.[143]

137 See In Re Thrun, 495 B.R. 861 (Bankr. W.D. Wis. 2013).

138 See, e.g. In Re Laminated Veneers Co., 471 F.2d 1124 (2d Cir. 1973).

139 See In Re McKenzie, 2011 WL 2118689 (Bankr. E.D. Tenn. May 27, 2011) (description found to be adequate since one could ascertain the collateral by reviewing debtor's books and records); In Re Delta Molded Prods., Inc. 416 F. Supp. 938 (N.D. Ala. 1976). See also, West. Dist. of Mich. Tr., Inc. v. First of Am. Bank–Ludington (In Re Pierce), 63 B.R. 740 (Bankr W.D. Mich. 1986).

140 See In Re Inofin, Inc., 455 B.R. 19 (Bankr. D. Mass. 2011) (security interest denied where security agreement defined collateral as that purchased with secured party's funds and there was no way to trace or otherwise determine what collateral was actually purchased with secured party's funds); In Re Martin Grinding & Mach. Works, Inc., 793 F.2d 592 (7th Cir. 1986). But see In Re Equip. Acquisition Res. Inc., 692 F.3d 558, 562 (7th Cir. 2012) (although a typo in the security agreement accidently granted secured party a lien in its own assets instead of debtor's assets, court upheld a reformation of the security agreement, relying upon, inter alia, the UCC-1 filed by the secured party which correctly referenced the lien, "thus reducing the potential that any creditor of (debtor) would get duped").

141 FSL Acquisition Corp. v. Freeland Systems, LLC, 2010 WL 605701 (D. Minn. Feb. 12, 2010) (reference in security agreement to bill of sale for collateral description upheld.)

142 See In Re Thrun, 495 B.R. 861 (Bank W.D.W. 2013).

143 See In Re LMJ, Inc., 159 B.R. 926 (D. Nev. 1993); see also In Re LDB Media, LLC, 497 B.R. 332 (Bankr. M.D. Fla. 2013); Fernandez v. White Rose Food Co., 824 N.Y.S.2d 753 (Bronx Co. 2006) (financing statement covering a "certain grocery store located at..." inadequate).

PRACTICE TIP: While Article 9 does not require the inclusion of serial numbers or similar identification in the security agreement, the secured party should at least have that information in its file. If the secured party seeks a replevin or even a self-help repossession of its collateral, specific identifying information will be critical. Some sheriffs and marshals will resist participating in an involuntary repossession without first being provided with detailed and specific identifying information. Other creditors with similar collateral may also contest repossession if a creditor cannot provide specific identifying information.

PRACTICE TIP: Do not use attachments unless absolutely necessary. If using attachments, make sure all the collateral "types" are listed on the financing statement and the more specific descriptions are on the attachment.

(b) Authenticate

The 1999 revisions to Article 9 broadened the definition of "authenticate" to mean

- To sign; or
- To execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

Clearly, this definition includes electronic transmissions. Indeed, even a voice mail can be an authentication.[144] Even before the 1999 revisions to Article 9 the courts liberally interrupted the requirement of authentication.[145]

(B) After-Acquired Collateral, Future Advances and Cross-Collateral Provisions

Unlike most real property lien laws, Article 9 specifically authorizes and approves "after-acquired" and "future advance" provisions.[146] This deviation from real property lien law is significant and can result in dramatically different results. After-acquired provisions entitle the secured party to obtain a lien to secure the loan in not only the existing assets of the debtor, but also in assets thereafter acquired by the debtor. Future

144 See U.C.C. § 9-102(a)(69).

145 See Sonnier v. Boudreaux, 673 So.2d 713 (La. Ct. App. 1986).

146 See U.C.C. § 9-204.

advance provisions entitle the secured party to secure not only an existing loan with a lien on the collateral, but also any future loans or advances. When used in tandem, these provisions enable a secured party to maximize its collateral for multiple loans, cross-collateralizing all loans with all collateral now existing or thereafter created.

As noted, Article 9 often limits some of the more aggressive provisions of Article 9 to non-consumer transactions and collateral. Consistent with this policy, after-acquired provisions are invalid in consumer goods except for accessions, unless the debtor acquires the goods within ten days after the secured party gives value.[147] Accordingly, in consumer transactions secured parties are wise to avoid cross-collateral and future advance provisions. After-acquired provisions are also invalid with respect to after-acquired commercial tort claims.[148]

Just as a security agreement must reasonably identify existing collateral, it should recite that it includes after-acquired collateral. It should also reasonably identify the type of after-acquired collateral intended, to assure compliance with U.C.C. § 9-108. Indeed, Official Comment 3 to § 9-108 specifically provides that whether after-acquired collateral is included is a "question of contract interpretation and is not susceptible to a statutory rule." Some courts have found a security interest to include after-acquired property despite the lack of a specific reference, when the lien was in inventory and accounts receivables.[149] A secured party should, however, not rely on this line of cases and should expressly provide for after-acquired collateral. Some courts have limited enforcement of these provisions to the immediate borrower.[150] Finally, a security interest in after-acquired property cannot attach, of course, until the debtor has rights in the property.

As with after-acquired collateral, the security agreement must specifically provide that future advances are covered.[151] Again, while no magic words are required, the

147 See U.C.C. § 9-204(b)(1).

148 See U.C.C. § 9-204(b)(2). This result is consistent with the requirement that a commercial tort claim must be specifically described in the security agreement. U.C.C. § 9-108(e). A commercial tort claim may, however, be proceeds of other collateral. U.C.C. §§ 9-102(a)(64), 9-203 and 9-315. See also Helms v. Certified Packaging Corp., 551 F.3d 675 (7th Cir. 2008).

149 See Paulman v. Gateway Venture Partners III, L.P. (In Re Filtercorp., Inc.), 163 F.3d 570 (9th Cir. 1998); In Re Nickerson & Nickerson, Inc., 329 F. Supp. 93 (D. Neb.), aff'd, 452 F.2d 56 (8th Cir. 1971).

150 See Starlines Int'l Corp. v. Union Planters Bank, N.A., 976 So.2d 1172 (Fla. Dist. Ct. App. 2008).

151 See U.C.C. § 9-204(c).

parties' intent must be clear.[152] Language that encompasses "any and all liabilities of debtor to creditor whether now existing or hereafter arising," should suffice.[153]

Even without a future advance clause, a secured party is perfected on a future loan with the collateral of a pre-existing loan when the secured party obtains a new security agreement again granting a lien in that collateral. If the original financing statement did not expire, the secured party need not file a new one.[154] A future advance may even be secured by original collateral under an earlier security agreement where the initial loan was paid in full and there was a gap before the future advance.[155]

The 1999 revisions to Article 9 rejected the prior line of cases that had held that future advances had to be of the same class of indebtedness.[156] Future advance is also broader than just money loaned.[157]

Official Comment 7 to § 9-204 makes clear that the need to reference after-acquired property and future advances in the security agreement does not extend to the financing statement.[158]

It should be noted that the United States Bankruptcy Code does not honor after-acquired provisions.[159] Thus, in the event of a bankruptcy filing by a debtor the secured party will need to obtain a post-petition replacement lien in order to continue to have a lien in assets acquired post-petition. Such post-petition replacement liens are often granted in connection with pre-petition inventory and accounts receivable liens as such are generally required, at a minimum, to provide the secured party with adequate protection of its pre-petition lien. While bankruptcy law cuts off after-acquired provisions,

152 See In Re Keeton, No. 07–11204–DHW, 2008 WL 686938 (Bankr. M.D. Ala. March 10, 2008). In California, the provision cannot secure a pre-existing debt unless the secured party proves that was the parties' intent. Gates v. Crocker-Anglo Nat'l Bank, 257 Cal. App. 2d 857, 858, 860-61 (Cal. Ct. App. 1968).

153 See, e.g., Commerce Union Bank v. Possum Holler, Inc., 620 S.W.2d 487 (Tenn. 1981). Cf. Kitmitto v. First Pa. Bank, N.A., 518 F. Supp. 297 (E.D. Pa. 1981) ("all sums or debts now or hereafter owed" held insufficient because existing debt would be "hereafter owed").

154 See U.C.C. § 9-323.

155 See Commercial Capital Bank v. House, No. 11-1796, 2012 WL 220214 (W.D. La. Jan. 24, 2012); In Re Howard, 312 B.R. 840 (Bankr. W.D. Ky. 2004); State Bank of Young Am. v. Vidmar Iron Works, Inc., 292 N.W.2d 244 (Minn. 1980).

156 See U.C.C. § 9-204 cmt. 5. See also Pride Hyundai, Inc. v. Chrysler Fin. Co., 369 F.3d 603 (1st Cir. 2004); Horob v. Farm Credit Servs., 777 N.W.2d 611 (N.D. 2010).

157 See U.C.C. § 9-205 cmt. 5.

158 See Sweney v. Cardinal Doors (In Re Door Supply Ctr., Inc.), 3 B.R. 103 (Bankr. D. Idaho 1980).

159 See 11 U.S.C. § 552(a) (2012). See In Re Lake at Las Vegas Joint Venture, LLC, 497 Fed. App'x 709 (9th Cir. 2012).

it does not cut off liens in proceeds of pre-petition collateral.[160] Thus, a post-petition battle will often turn on whether the collateral at issue is new collateral generated post-petition or is merely proceeds of pre-petition collateral.[161] For a more extensive discussion of whether post-petition assets are new assets or proceeds of pre-petition collateral see Chapter VI section (A) (iii), Bankruptcy and Fraudulent Transfers, After-Acquired Collateral, infra.

Finally, while the Bankruptcy Code does not honor after-acquired provisions as to assets created post-petition, the Bankruptcy Code does not negate these provisions pre-petition, and thus, a Plan of Reorganization may not strip a secured creditor of a cross-collateralization provision.[162]

PRACTICE TIP: A secured party should consider the bankruptcy preclusion of after-acquired clauses when drafting collateral descriptions. By way of example, the secured party should be sure to get a lien on "general intangibles" as well as "accounts" because a lien on accounts only will not apply to accounts generated post-petition, but a lien on general intangibles will apply to all contracts, and thus, to accounts generated by that contract even though the account is generated post-petition.

(C) Proceeds and Accessions

(i) *Proceeds*

An Article 9 lien, again unlike a real property lien, automatically attaches to and is perfected in the proceeds of a secured party's collateral,[163] even if the security agreement does not specifically state "proceeds."[164] Thus, upon the sale or lease or licensing of a secured party's collateral, the lien follows and attaches to the proceeds automatically and without further notice or action by the secured party. This lien in proceeds, however, becomes unperfected on the 21st day after the security interest attaches to the proceeds unless extended under U.C.C. § 9-315(d).[165] Notably, the secured party is

160 See 11 U.S.C. §552(b).

161 See In Re Lake at Las Vegas Joint Venture, supra.

162 See In Re Heath, 483 B.R. 708 (Bankr. E.D. Ark. 2012).

163 See U.C.C. §§ 9-203(f) and 9-315(c).

164 See City of Chi. v. Mich. Beach Hous. Coop., 242 Ill. App. 3d 636, 609 N.E.2d 877 (Ill. App. Ct. 1993); U.C.C. § 9-102(a)(12).

165 See Chapter IV Priority of Liens, infra.

authorized to file a financing statement against the proceeds to extend same, beyond 20 days, again even if the security agreement does not expressly cover proceeds.[166]

Article 9 also has an expansive definition of "proceeds" including dividends on investment property and rents and royalties arising out of the leasing of goods or the licensing of general intangibles.[167]

While Article 9 does not apply to insurance claims except health care receivables, proceeds includes insurance proceeds to the extent paid due to loss or damage to collateral as well as settlement monies paid due to destruction of the collateral.[168] Thus, a secured party is entitled to insurance proceeds even if it is not a loss payee on the policy. However, if the secured party is not a loss payee the insurance company is not obligated to protect the secured party's interest.[169] Indeed, at least one court has held that a junior lienholder had priority to an insurance check, as insurance proceeds, where the insurance policy listed the junior lienholder as loss payee.[170] Thus, the secured party must insist that the debtor have insurance and that the secured party is named as a loss payee.[171] The secured party should insist that it is listed as a "lender/loss payee" because a lender loss payee enjoys additional protections including the ability to file claims. Indeed, whenever possible, the secured party should be listed as an additional insured as well. Unless it is listed as an additional insured, the secured party generally cannot enforce the policy without the debtor's cooperation.

One court has held that proceeds of "seeds, chemicals and fertilizer" do not include "crops."[172] While proceeds would clearly include rentals or sales proceeds from the rental or sale of equipment collateral, proceeds does not include accounts receivables generated by the use of the equipment in the ordinary course.[173]

166 See U.C.C. § 9-509(b)(2).

167 See U.C.C. § 9-102(a)(64).

168 See In Re Wiersma, 324 B.R. 92 (B.A.P. 9th Cir. 2005), aff'd in part, rev'd in part, 483 F.3d 933 (9th Cir. 2007). See also In Re Tower Air, Inc., 397 F.3d 191 (3d Cir. 2005). Business interruption insurance may not, however, come within "proceeds". In Re Montreal Maine & Atlantic Railway, Ltd., 2014 WL 1491301 (Bankr. D. Maine 2014).

169 See Fidelity Fin. Servs. v. Blaser, 889 P.2d 268 (Okla. 1994).

170 See In Re Courson, 409 B.R. 516 (Bankr. E.D. Wash. 2009).

171 A secured party may have liability to a junior creditor if it does not protect the junior creditor's interests. If the secured party receives surplus insurance proceeds, the secured party should determine whether there are any junior creditors before turning over any surplus to the debtor. E.F. Hutton & Co. v. Helmer, 1982 WL 170991 (D. Kan. Jan. 5, 1982).

172 See Searcy Farm Supply, LLC v. Merch. & Planters Bank, 369 Ark. 487, 256 S.W.3d 496 (Ark. 2007).

173 See 1st Source Bank v. Wilson Bank & Trust, 735 F.3d 500 (6th Cir. 2013).

A PMSI priority lien in inventory will only have priority over proceeds to the extent the proceeds are chattel paper or instruments where so provided in § 9-330 and in identifiable cash proceeds if the proceeds are received on or before delivery of the inventory to the person who buys them from the debtor. As noted above, proceeds include insurance proceeds.[174] In contrast, the PMSI priority lien in livestock proceeds extends to all identifiable proceeds, not just identifiable cash proceeds, and even to identifiable products.[175] See Chapter IV, (G) infra for a more complete discussion of PMSI, liens, including priority in proceeds, in Purchase Money Security Interest section, infra.

PRACTICE TIP: The lien in proceeds of collateral is even honored in bankruptcy court, where the proceeds were generated post-petition[176]. With inventory collateral, the description in the security agreement should also include "returns, repossessions, substitutions, exchanges and accessions," although all of these should be included in "proceeds" under 9-315.

(ii) *Accessions*

If the security agreement includes in the definition of collateral accessories, attachments or accessions, these will automatically become part of the collateral upon physical attachment without any action by the secured party or debtor.[177] Accessions are defined as "goods that are physically united with other goods in such a manner that the identity of the original goods is not lost." [178]

174 See U.C.C. § 9-324(b).

175 See U.C.C. § 9-324(d).

176 See 11 U.S.C. § 552(b).

177 See U.C.C. § 9-335(a). The priority of competing secured parties with liens in collateral that become attached to the other is determined in accordance with Article 9's general priority rules, except in the case of a titled vehicle, in which case the secured party with a lien on the titled vehicle always prevails. See Chapter IV, (I) (Accessions), supra.

178 See U.C.C. § 9-102(a)(1).

III

PERFECTING A SECURITY INTEREST

A security interest must have attached under U.C.C. § 9-203, as discussed in Chapter II, before it may be perfected. Perfection of a lien under Article 9 is generally effectuated in one or more of four ways: automatically, filing a financing statement, taking possession or obtaining control. Often a lien may be perfected in more than one of these ways, but one of the ways will provide greater protection and priority than the other(s). For example, a lien may be perfected in chattel paper by filing a financing statement or by taking possession, but if the secured party chooses to perfect the lien by filing only it may not have priority over a subsequent purchaser who takes possession without knowledge that his actions violate the first lienholder's lien. Thus, when a lien may be perfected in more than one way, it is generally advisable to perfect the lien in multiple ways, or if that is not possible, to perfect the lien in the way that is most protective of the secured party.

Automatic Perfection is not the norm. Generally, a purchase money security interest ("PMSI") in consumer goods is automatically perfected. A few of the other cases in which perfection is automatic include: (1) assignments of accounts or payment intangibles that are not a significant part of the outstanding accounts or payment intangibles;[179] (2) health care insurance receivables assigned to the provider of health care goods or

179 See U.C.C. § 9-309(2).

services:[180] (3) sales of payment intangibles[181] and promissory notes;[182] (4) estates;[183] and (5) supporting obligations (e.g. letter of credit).[184]

The few cases of automatic perfection also include the few cases in which perfection is temporary:

- A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession for a period of 20 days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

- A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for 20 days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

  - Ultimate sale or exchange; or
  - Loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.

- A perfected security interest in a certificated security or instrument remains perfected for 20 days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:

  - Ultimate sale or exchange; or
  - Presentation, collection, enforcement, renewal, or registration of transfer.
  - (Upon expiration of the 20-day periods above, the usual rules of priority govern.[185])

180 See U.C.C. § 9-309(5).
181 See U.C.C. § 9-309(3).
182 See U.C.C. § 9-309(4).
183 See U.C.C. § 9-309(13).
184 See U.C.C. § 9-308(d).
185 See U.C.C. § 9-312(h).

- A lien in "proceeds" continues for 20 days and perhaps longer as provided in U.C.C. § 9-315.

In the balance of cases, except for money (which must always be possessed), if the collateral is tangible or quasi-tangible (i.e., non-electronic chattel paper), the lien may generally be perfected through filing or possession. If the collateral is intangible (i.e., accounts), the lien must be perfected through filing except in the cases of deposit accounts, electronic chattel paper and letter of credit rights in which the lien must be perfected by control. In the case of investment accounts, the lien may be perfected by filing or control. These are only generalizations, however and the specific perfection rules are set forth more fully below.

To determine how to perfect a lien, you must first determine the "type" of collateral you are working with, as defined by Article 9. In most cases determining the "type" of collateral is simple. In some cases, however, determining the "type" of collateral may be difficult, and indeed, the collateral may potentially fall into two or more categories. If the collateral may fall into two or more categories, the secured party should perfect as required for each of the potential "types" within which the collateral may fall. In larger transactions, a secured party should further consider obtaining an attorney opinion letter or insurance on issues of perfection and even attachment and priority. Insurance will generally be considered a credit enhancement, but an attorney opinion letter will probably not. Finally, as noted above consignments are also covered by Article 9, and the consignor must comply with the perfection requirements, even in the case of a true consignment.[186]

(A) Types of Collateral

Section 9-102 (a) provides specific definitions for many types of collateral. These definitions range from "accounts" to "payment intangibles" and from "crops" to "equipment."

186 A "consignment" is defined as follows: A transaction, regardless of its form, in which a person delivers goods to merchant for the purchase of sale and;
(1) The merchant:
a. Deals in goods of that kind under a name other than the name of the person making delivery;
b. Is not an auctioneer; and
c. Is not generally known by its creditors to be substantially engaged in selling goods of others;
(2) With respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery;
(3) The goods are not consumer goods immediately before delivery; and
(4) The transaction does not create a security interest that secures an obligation. U.C.C. § 9-102(a)(20).

(i) ***Account***[187] – a right to payment of a monetary obligation, whether or not earned by performance,[188] for property sold, leased, licensed, assigned or otherwise disposed of, for services rendered or to be rendered, under an insurance policy issued or to be issued, for energy, for hire of a vessel, arising out of the use of a credit card, winnings in a lottery (i.e., accounts receivables, credit card receivables, possibly revenues from the sale or license or software). Accounts include health care insurance receivables. Rights to payment excluded from accounts are rights to payment evidenced by chattel paper or an instrument, commercial tort claims, deposit accounts, investment property, letter of credit rights or letters of credit, and rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit card or charge card.

Note: A seller of an account does not retain any interest, legal or equitable.[189] This revision to Article 9 was designed to overrule Octagon Gas Systems, Inc. v. Rimmer (In Re Meridian Reserve, Inc.), 995 F.2d 948 (10th Cir. 1993) (account seller retained an interest that was a part of the bankrupt estate). The seller is, however, still "deemed" to have the rights

187 See U.C.C. § 9-102(a)(2). The secured party must beware of the borrower who is not in the business of buying and reselling goods, but rather is a distributor. Many distributor agreements provide that the receivables are the property of the manufacturer. The secured party should also be aware that there are an abundance of statutes and regulations governing government receivables that generally relieve the government of any obligation to recognize the pledge or assignment of a receivable unless the secured party meets certain notice and other procedural requirements. See, e.g., 31 U.S.C. § 3727. The secured party should still further be aware that there is some disagreement among the states as to whether hotel revenues are rents or accounts (or payment intangibles). If the revenues are rents under the state law at issue, the secured party generally needs to file against same under an Assignment of Rents with the mortgage documents. If the revenues are accounts under the state law at issue, the secured party needs to file a UCC-1. Thus, the secured party should generally do both. In Re Old Colony, LLC, 476 B.R. 1 (Bankr. D. Mass. 2012); In Re Ocean Place Dev., LLC, 447 B.R. 726 (Bankr. D.N.J. 2011) (hotel rents are accounts and are distinguishable from rents under a lease); In Re Northview Corp., 130 B.R. 543 (B.A.P. 9th Cir. 1991) (hotel room revenues are accounts). Finally, an account may even "arise" in a cash sale. In Re Delta-T Corp., 475 B.R. 495 (Bankr. E.D. Va. 2012).

188 Accounts include rights to payment for incomplete sales. Incomplete sales are not good collateral, and thus, lenders should be reluctant to lend against incomplete sales.

189 See U.C.C. § 9-318(a).

it sold until the buyer perfects its interest, so that a second buyer without knowledge of the first sale may take good title.[190]

Note: The definition of "accounts" was substantially enlarged under Revised Article 9. Under the old law accounts only included the right to payment for goods sold or leased or for services rendered. The new definition includes, inter alia, the right to payment for property sold, leased, licensed, assigned or otherwise disposed of and the right to payment for money or funds advanced arising out of the use of a credit card. ("Funds" is a broader concept than "money", the latter of which is essentially limited to currency under U.C.C. § 1-201.) As a result, accounts now include many items that would have been general intangibles under the old law and even many that would have otherwise fallen into the new sub-category of payment intangible. Indeed, under the new law you can have certain rights that are bifurcated, with part of the right being an account and other parts being a general intangible. By way of example, the right to payment under a software license agreement will now be an account, but the general ownership and rights of the license are general intangibles.

(a) Health Care Insurance Receivables[191] – A claim under a policy of insurance for health care goods or services provided. (Does not include Medicare or Medicaid)

- Because health care insurance receivables are a sub-category of "accounts," they have the same exceptions such as sales in connection with the sale of a business.[192]
- Because the payor on a health care insurance receivable is an insurance company and other law governs same, health care receivables are excluded from the rules addressing account debtors rights and duties.[193]
- Other types of insurance claims are not covered by Article 9 except to the extent they may be proceeds.[194]

190 See U.C.C. § 9-318(b).

191 See U.C.C. § 9-102(a)(46).

192 See U.C.C. §§ 9-109(d)(4), 9-405(d) and 9-406(i).

193 See U.C.C. § 9-404(e).

194 See U.C.C. § 9-109(d)(8).

(ii) ***Agricultural Lien***[195] – an interest, other than a security interest, in farm products: which secures payment or performance of an obligation for: goods or services furnished in connection with a debtor's farming or operation; or rent on real property leased by a debtor in connection with its farming operation; which is created by statute in favor of a person that; in the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; and whose effectiveness does not depend on the person's possession of the personal property.

(iii) ***As-Extracted Collateral***[196]

(a) Oil, gas or other minerals that are subject to a security interest that:

- Is created by a debtor having an interest in the minerals before extraction; and
- Attaches to the minerals as extracted; or

(b) Accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor had an interest before extraction.

Note: This is a very tricky definition. Oil, gas and other minerals not yet extracted from the ground are real property, and thus Article 9 does not apply.[197] Oil, gas and other minerals that have been fully extracted before the debtor acquires an interest in them, such as coal purchased by a manufacturer, are "goods" under Article 9. "As-extracted collateral" exists only where the debtor had an interest in the collateral before extraction and the security interest attaches as the collateral is extracted, that is, as the oil, gas and other minerals pass from real estate to goods.

(iv) ***Chattel Paper***[198] – A record or records that evidence both a monetary obligation and a security interest in goods (i.e., equipment finance

195 See U.C.C. § 9-102(a)(5).
196 See U.C.C. § 9-102(a)(6).
197 See U.C.C. § 9-109(11).
198 See U.C.C. § 9-102(11).

agreement, promissory note with security agreement, conditional sales agreement). If a transaction is evidenced by a series of instruments, the group of instruments constitutes the chattel paper.

Note: When chattel paper includes a negotiable instrument, enforcement is governed by Article 3, not Article 9, because Article 9 excludes from the definition of "account debtor," "persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper."[199] Thus U.C.C. §§ 9-403, 9-404 and 9-406 do not apply when chattel paper include a negotiable instrument.

Note: Under the 2010 Amendments an assignment of the payment stream of chattel paper will also constitute chattel paper, and not a payment intangible. (See Payment Intangibles, infra.) Charters of vessels are expressly excluded from the definition of chattel paper and are expressly included in the definition of accounts.

Note: Chattel paper can include not only obligations secured by goods but also by software to the extent that the software is sold or leased in an integrated transaction together with specific goods.[200]

(v) ***Commercial Tort Claim***[201] – A claim by an organization or a claim by an individual arising out of a business or profession for non-personal injury.

---

199 See U.C.C. § 9-102(a)(3).

200 See U.C.C. § 9-102(a)(11).

201 See U.C.C. § 9-102(13). A breach of contract claim in litigation is likely to be proceeds of an account or a general intangible, not a commercial tort claim. Many times litigation will include contract and tort claims. If there is any doubt about the nature of the claims the secured party should be sure to comply with the specific requirements for obtaining a security interest in a commercial tort claim. See Chapter II (A) (iii) (a), supra. Of course, the secured party should also be sure to perfect against both commercial tort claims and general intangibles, including both in the financing statement. It must be further noted that once litigation is reduced to a judgment, Article 9 does not apply to the assignment of an interest in a judgment unless the litigation was for proceeds of the original collateral, such as accounts or general intangibles. Finally, if the claim in the litigation was not a commercial tort or breach of contract claim, but was a personal injury claim, it cannot be the subject of an original collateral claim and can only become subject to Article 9 when and if the claim is settled and becomes an obligation to pay, at which time it is a payment intangible. See U.C.C. § 9-109, cmt 15. Thus, a secured party cannot obtain a security interest under Article 9 in a personal injury case unless and until it has settled and become an obligation to pay. And a secured party cannot obtain a security interest in a judgment unless it is the proceeds of original collateral or it has been settled and become an obligation to pay.

(vi) ***Consignments***[202] – A transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and: (A) the merchant: (i) deals in goods of that kind under a name other than the name of the person making delivery; (ii) is not an auctioneer; and (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others; (B) with respect to each delivery, the aggregate value of the goods is $1,000 or more at the time of delivery; (C) the goods are not consumer goods immediately before delivery; and (D) the transaction does not create a security interest that secures an obligation. Consignments are often inventory under Article 9, and thus, a secured party must be sure to not only perfect its position, but also that to comply with the inventory special timing and notice provisions.

(vii) ***Crops*** – See Farm Products, infra.[203]

(viii) ***Deposit Account*** – A demand, time, savings, passbook, or similar account maintained with a bank. "A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such an instrument cannot be perfected by 'control' (see Section 9-104) and the special priority rules applicable to deposit accounts (see Sections 9-327 and 9-340) do not apply. The term 'deposit account' does not include 'investment property,' such as securities and security entitlements. Thus, the term also does not include shares in a money market mutual fund, even if the shares are redeemable by check."[204] Accounts evidenced by an instrument (or a security interest in a deposit account in a consumer transaction except with regard to proceeds of other collateral deposited into the account) are excluded from the term "deposit accounts."[205] Deposit accounts include uncertificated certificates of deposit (assuming no writing evidencing the bank's obligation to

202 See U.C.C. § 9-102(a)(20).

203 Christmas trees may be "crops" or "timber." See In Re Grogan, 2013 WL 5630627 (B.A.P. 9th Cir. Oct. 15, 2013).

204 See U.C.C. § 9-102(a)(29) cmt. 12. For an excellent discussion of the difference between a deposit account and an investment account, See In Re Gem Refrigerator Co., 512 B.R. 194 (Bankr. E.D. Pa. 2014).

205 See Id.; U.C.C. § 9-109(d)(13).

pay),[206] but a non-negotiable certificate of deposit, which may be certificated, is a deposit account only if it is not an "instrument," which will depend on whether it is of a type that in the ordinary course is transferred by delivery with an endorsement or assignment.[207]

Note: Because deposit accounts are now a separate and specific collateral category, the security agreement must specifically state "deposit accounts" and a secured party may not rely upon a reference to general intangibles.

(ix) ***Documents***[208] – A document of title or a receipt as described in U.C.C. § 7-201(2) (i.e., bills of lading, warehouse receipts,[209] dock warrants, dock receipts).

(x) ***Fixtures***[210] – Goods that have become so related to particular real property that an interest in them arises under real property law. (Equipment may not be a fixture even if it is installed in real estate.[211]) Note that certain trade fixtures, which are readily removable machines and equipment, are treated differently under Article 9 than traditional fixtures.[212]

206 See Id. § 9-102(a)(29) cmt. 12; Pioneer Commercial Funding Corp. v. Am. Fin. Mortg. Corp., 855 A.2d 818, 828 (Pa. 2004); In Re Ala. Land & Mineral Corp., 292 F.3d 1319, 1325-26 (11th Cir. 2002).

207 See U.C.C. § 9-102 cmt. 12. See also E53 Fed. Credit Union v. Perez (In Re Perez), 440 B.R. 634 (Bankr. D.N.J. 2010) (book entry CD, even though certificated, is deposit account and not instrument where expressly non-negotiable and not transferred in the ordinary course with an endorsement); Peters v. Cent. Cal. Elecs., Inc., 2007 WL 2380370 (Cal. Ct. App. Aug. 22, 2007).

208 See U.C.C. § 9-102(a)(30).

209 There are generally two types of warehouse receipts: the terminal warehouse and the field warehouse. The terminal warehouse is used by the typical seller to store goods off the seller's premises. The owner/operator issues the seller a warehouse receipt that can be negotiable or non-negotiable. In the case of a field warehouse the borrower leases a portion of its premises to a field warehouse operator, who monitors and maintains the inventory for the secured party. The inventory is only released to the borrower upon payment or the substitution of new inventory.

210 See U.C.C. § 9-102(a)(41).

211 See In Re Marble Cliff Crossing Apartments, LLC, 484 B.R. 175 (Bankr. S.D. Ohio 2012) (Internet system was held to be "equipment" and not a "fixture" even though it was installed on an apartment complex).

212 See U.C.C. § 9-334(e)(2). See also How To Perfect In Various Types of Collateral, Fixtures subsection, infra.

(xi) ***General Intangibles***[213] – This is a catch-all. It includes any personal property not included in the other categories and oil, gas and other minerals before extraction. "Examples are various categories of intellectual property and the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument."[214]

(a) Items that have been determined to be general intangibles include the following:

- Right of payment that does not come within the definition of "accounts";[215]
- Note that does not come within the definition of an "instrument";[216]
- Interest in real estate contracts;[217]
- Unregistered copyrights;[218]
- Proceeds of settlement of a breach of contract or tort action;[219]
- Construction Bonds;[220]

213 See U.C.C. § 9-102(a)(42).

214 See U.C.C. § 9-102 cmt. 5(d).

215 See Tew v. Res. Mgmt. (In Re ESM Gov't Sec., Inc.), 812 F.2d 1374 (11th Cir. 1987); Smith v. Iron & Glass Bank (In Re SSE Int'l Corp.), 198 B.R. 667, 671-72 (W.D. Pa. 1996).

216 See Craft Prods., Inc. v. Hartford Fire Ins. Co., 670 N.E. 2d 959 (Ind. Ct. App. 1996).

217 See Fodale v Waste Mgmt., Inc., 271 Mich. App 11, 718 N.W. 2d 827 (Mich. Ct. App. 2006) (assignment of developers rights in building contract); Fleet Nat'l Bank v. Whippany Venture I, LLC (In Re IT Grp., Inc.), 307 B.R. 762 (D. Del. 2004). An unexercised option to lease real property has been held to be a general intangible. Olm Assocs. V. Bright Band Sav. Ass'n (In Re Olm Assoc.). 98 B.R. 271 (Banks N.D. Tex 1989).

218 See Aerocon Eng'g, Inc. v. Silicon Valley Bank (In Re World Auxiliary Power Co.), 303 F.3d 1120 (9th Cir. 2002).

219 See Houston v. Eiler (In Re Cohen), 305 B.R. 886 (B.A.P. 9th Cir. 2004); In Re Allegheny Imaging Inst., 69 B.R. 932 (W.D. Pa. 1987) (holding liquidated damages in a deposit account to be proceeds of the breached contract). In light of the 1999 Revisions to Article 9 adopting "commercial tort claims" as a separate category of collateral, commercial tort claims no longer come within the category of general intangibles. See Footnote 201 for a discussion of the differences between commercial tort claims, breach of contract claims and settlement agreements in connection with litigation and judgments, as same may result in accounts' proceeds, general intangibles, commercial tort claims, payment intangibles or not being covered by Article 9.

220 See First Nat'l Bank of Litchfield v. O'Neil (In Re Litchfield Constr. Mgmt., Inc.), 137 B.R. 98, 100 (Bankr. D. Conn. 1992).

- Domain Name;[221]
- Covenant not to compete;[222]
- Interest in a management contract;
- Patents;[223]
- Partner's interest in a partnership;[224]
- Termination Fee;[225]
- Trademarks;[226]
- Member's interest in an LLC.[227] An interest in a partnership or LLC is not, however, a general intangible, but is a "security" under Article 8 if:[228]

  - The LP or LLC interest is "dealt in or traded on securities exchanges or in securities markets";
  - Its terms expressly provide that it is a security governed by U.C.C. Article 8 (i.e., the LP or LLC has elected to "opt in" to U.C.C. Article 8's rules governing securities);
  - The LP or LLC interest is an "investment company security" under the federal investment company laws, or;
  - The LP or LLC interest is held in a brokerage or similar securities account. See U.C.C. § 8-103(c).

---

221 Courts have sometimes characterized domain names as contractual rights. Dorer v. Aral, 60 F. Supp. 2d 558, 559-61 (E.D. Va. 1999); Zurakov v. Register.Com, Inc., 304 A.D.2d 176, 179-180, 760 N.Y.S.2d 13, 15 (N.Y. App. Div. 2003); Network Solutions, Inc. v. Umbro Int'l, Inc., 259 Va. 759, 770-771, 529 S.E.2d 80, 86 (Va. 2000). Contractual rights are usually general intangibles. See General Intangibles supra. Courts have also sometimes just treated domain names as simple general intangibles. See Kremen v. Cohen, 337 F.3d 1024, 1030 (9th Cir. 2003); accord, CRS Recovery, Inc. v. Laxton, 600 F.3d 1138, 1142 (9th Cir. 2010).

222 See Orix Credit Alliance, Inc. v. Omnibank, N.A., 858 S.W.2d 586 (Tex. App. 1993).

223 See Moldo v. Matsco (In Re Cybernetic Servs., Inc.), 252 F.3d 1039 (9th Cir. 2001).

224 See In Re Mintz, 192 B.R. 313 (Bankr. D. Mass. 1996).

225 See NBD Park Ridge Bank v. SRJ Enters., Inc. (In Re SRJ Enters., Inc.), 150 B.R. 933 (Bankr. N.D. Ill. 1993).

226 Trimarchi v. Together Dev. Corp., 255 B.R. 606 (D. Mass. 2000).

227 See In Re Dreiling, 2007 WL 172364 (Bankr. W.D. Mo. Jan. 18, 2007). If the interest is not certificated, it is possible, but not likely, that it could be considered an instrument. U.C.C. §§ 9-102(a)(42) and (47).

228 The typical hedge fund is organized as an LLP or LLC.

- Liquor License – The issue of whether security interests in liquor licenses are within the scope of Article 9 is really a non-Code issue depending on whether local law permits such liens.[229] Before the 1999 revisions to Article 9, state statutes often placed additional restrictions on the assignment of liquor licenses as collateral, such as approval by a regulatory body. Unless those supplemental statutes have been rewritten since the adoption of the revisions, they are overridden by U.C.C. § 9-408(c), although several state courts have taken the position that no security interest can attach to liquor licenses or that liquor licenses are not property.[230]
- FCC License[231] – Note that the security interest may be limited to the private right to receive economic value, but not attach directly to the FCC license itself;[232]
- State[233] and Federal[234] permits and licenses;
- Cooperative apartments; and[235]
- Tax refunds.[236]

229 However, Article 9, as revised in 1999, should apply to liquor licenses unless the state statute has been modified since the revisions to Article 9, although the enforceability of the lien is dubious under U.C.C. § 9-408.

230 See Jojo's 10 Restaurant, LLC v. Devin Props., LLC (In Re Jojo's 10 Restaurant, LLC), 455 B.R. 321 (Bankr. D. Mass. 2011) (a security interest cannot attach to a liquor license without state approval); Bischoff v. LCG Blue, Inc., 2009 WL 148519 (Cal. Ct. App. Jan. 22, 2009) (no security interest can attach to liquor license under California law); Banc of Am. Strategic Solutions, Inc. v. Cooker Restaurant Corp., 2006 WL 2535734 (Ohio Ct. App. Sept. 5, 2006), appeal denied, 861 N.E.2d 144 (Ohio 2007) (a liquor license is not property under Ohio law); In Re Chris-Don, Inc., 367 F. Supp. 2d 696 (D.N.J. 2005) (liquor license not property under New Jersey law).

231 See MLQ Investors, L.P. v. Pacific Quadracasting, Inc., 146 F.3d 746 (9th Cir. 1998), cert. denied, 525 U.S. 1121 (1999); Sprint Nextel Corp. v. U.S. Bank Nat'l Assoc. (In Re Terrestar Networks, Inc.), 457 B.R. 254 (Bankr. S.D.N.Y. 2011).

232 See Valley Bank & Trust Co. v. Spectrum Scan, LLC (In Re Tracy Broadcasting Corp.), 696 F.3d 1051 (10th Cir. 2012), cert. denied, 133 S. Ct. 2340 (2013). See also, In Re Terrestar Networks, supra note 235.

233 See Lake Region Credit Union v. Crystal Pure Water, Inc. 502 N.W. 2d 524 (N.D. 1993).

234 See State St. Bank & Trust Co., v. Arrow Comm'ns., 883 F. Supp. 41 (D. Mass. 1993).

235 See First Sav. Bank of Va. v. Barclays Bank, S.A., 618 A.2d 134 (D.C. Ct. App. 1992) (coop apartment not an "instrument" and no perfection absent filing). See also New York's nonuniform amendment, subsection (xxii), infra.

236 See Brandt v. Fleet Capital Corp (In Re TMCI Elecs.), 279 B.R. 552, 555 (Bankr. N.D. Cal. 1999); Official Comm. of Unsecured Creditors of TOUSA, Inc. v. Citigroup N. Am., Inc. (In Re Tousa, Inc.), 406 B.R. 421, 429 (Bankr. S.D. Fla. 2009).

Note: The definition of "accounts" was substantially enlarged under Revised Article 9. Under the old law accounts only included the right of payment for goods sold or leased or for services rendered. The new definition includes, inter alia, the right to payment for property sold, leased, licensed, assigned or otherwise disposed of and the right to payment for money or funds advanced arising out of the use of a credit card. ("Funds" is a broader concept than "money", the latter of which is essentially limited to currency under U.C.C. § 1-201.) As a result, accounts now include many items that would have been general intangibles under the old law and even many that would have otherwise fallen into the new sub-category of payment intangible. Indeed, under the new law you can have certain rights that are bifurcated, with part of the right being an account and other parts being a general intangible. By way of example, the right to payment under a software license agreement will now be an account, but the general ownership and rights of the license are general intangibles.

Note: Under Revised Article 9 commercial tort claims, deposit accounts, and letter-of-credit rights were excluded from the definition of general intangibles. "As a result of this exclusion tortfeasors (commercial tort claims), banks (deposit accounts), and persons obligated on letters of credit (letter-of-credit rights) are not "account debtors" having the rights and obligations set forth in Sections 9-404, 9-405 and 9-406. Thus, tortfeasors, banks, and persons obligated on letters of credit are not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-404(a). See Comment 5.h."

(b) Payment Intangibles[237] – general intangibles under which the debtor's principal obligation is monetary (i.e., the right to payment under a loan or a

237 See U.C.C. § 9-102(61).

fractional share of a loan without an instrument or chattel paper,[238] the right to payment under a structured settlement,[239] including from the destruction of collateral).[240]

Note: "Payment Intangibles is a subset of the definition of 'general intangible'.... Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation. The term 'payment intangible,' however, embraces only those general intangibles 'under which the account debtor's principal obligation is a monetary obligation'.... A right to the payment of money is frequently buttressed by ancillary rights, such as rights arising from covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral, rights arising from covenants to preserve the creditworthiness of the promisor.... [Article 9] does not treat these ancillary rights separately from the rights to payment to which they relate. For example, attachment and perfection of an assignment of a right to payment of a monetary obligation, whether it be an account or payment intangible, also carries these ancillary rights."[241]

238 See Wiersma v. O.H. Kruse Grain & Milling (In Re Wiersma), 324 B.R. 92, 106-07 (B.A.P. 9th Cir. 2005), aff'd in part, rev'd in part, 483 F.3d 933 (9th Cir. 2007). The 2010 Amendments in Official Comment 5, provide that an assignment of rights to payment on collateral does not create a separate property interest or type of collateral, but rather such rights are part of the payment rights to which they relate. Thus, if the lessor's rights are "evidenced by chattel paper, then an assignment of the lessor's rights to payment constitutes an assignment of chattel paper." U.C.C. § 9-102, cmt. 5d. Absent this 2010 Amendment, the assignment of payment rights under chattel paper constituted a payment intangible. NetBank, FSB v. Kipperman (In Re Commercial Money Ctr., Inc.), 350 B.R. 465 (B.A.P. 9th Cir. 2006).

239 The settlement of a tort claim is a right to payment, not a tort and, therefore, is not exempt from Article 9.

240 See U.C.C. § 9-102(a)(61). See also In Re Commercial Money Ctr., Inc.), 350 B.R. 465 (B.A.P. 9th Cir. 2006).

241 See U.C.C. § 9-102 cmt. 5(d).

(xii) ***Goods***[242] – All things movable, including fixtures, timber to be cut and removed, and farm products.

(a) **Accession**[243] – Goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.

(b) **Consumer Goods**[244] – Goods used or bought for use primarily for personal, family or household purposes.

(c) **Crops**[245] – Includes crops grown, growing, or to be grown, even if the crops are produced on trees, vines or bushes.

(d) **Equipment**[246] – Equipment is a default category. It includes all goods other than inventory, farm products or consumer goods. (i.e. computers, office furniture and equipment, non-titled machinery and Taxi-Medallions[247])

(e) **Farm Products**[248] – Other than standing timber with respect to a farming operation and are crops grown, growing or to be grown, including crops produced or trees, vines and bushes, aquatic goods, livestock, born or unborn, including aquatic, supplies in a farming operation or product of crops or livestock in an unmanufactured state.[249]

---

242 See U.C.C. § 9-102(a)(44). While the classes of goods are mutually exclusive, "[g]oods can fall into different classes at different times." U.C.C. § 9-102, cmt. 4(a). "For example, a radio may be inventory in the hands of a dealer and consumer goods in the hands of a consumer." Id. "Goods are inventory if they are leased by a lessor or held by a person for sale or lease." Id. "Goods are 'farm products' if the debtor is engaged in farming operations with respect to the goods." Id. "Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process.... Once farm products have been subjected to a manufacturing operation, they normally become inventory." Id.

243 See U.C.C. § 9-102(a)(1).

244 See U.C.C. § 9-102(a)(23).

245 See U.C.C. § 9-102(a)(44).

246 See U.C.C. § 9-102(a)(33).

247 See In Re Karachi Cab Corp., 21 B.R. 822 (Bankr. S.D.N.Y.1982).

248 See U.C.C. § 9-102(a)(34).

249 See U.C.C. §§ 9-102(a)(48), 9-102(a)(34). Aquatic goods that are vegetable in nature are generally crops and those that are animal in nature are generally livestock, but the courts are free to classify same on a case by case basis. U.C.C. § 9-102, cmt 4a.

(f) Inventory[250] – Goods, other than farm products, for sale or lease including raw materials, work in process or materials used or consumed in business.[251]

Note: Inventory includes "new materials and materials used or consumed in business..."[252] Thus, inventory can include items not held for sale or lease.

Note: Titled vehicles can also be inventory. See How to Perfect in Various Types of Collateral, Titled Vehicles subsection, infra.

(g) Manufactured Home[253] – A structure, transportable in one or more sections, which, when erected on site, is 320 or more square feet and designed to be used as a dwelling, can be consumer goods.

(h) Standing Timber – Standing timber to be cut and removed under a conveyance or contract for sale.[254]

(xiii) ***Instrument***[255] – A negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that is in the ordinary course of business transferred by delivery with any necessary endorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to

250 It is the intended use or disposition of the goods that determines whether they are inventory. The sale or lease must be in the ordinary course.

251 See U.C.C. § 9-102(a)(48).

252 See U.C.C. § 9-102(a)(48)(D).

253 See U.C.C. § 9-102(a)(54).

254 See U.C.C. §§ 9-102(a)(44) and 9-502(b). Christmas trees may be "crops" or "timber." See In Re Grogan, 2013 WL 5630627 (B.A.P. 9th Cir. Oct. 15, 2013).

255 See U.C.C. § 9-102(a)(47). Under U.C.C. § 3-103 a negotiable instrument must be in writing. Because the definition of instrument under Article 9 is "a negotiable instrument or any other writing", in order to be an instrument under Article 9, it must be in writing. U.C.C. § 9-102(a)(47). Thus, an instrument may not be in electronic form under Article 9. Notably, instrument is the only definition under Article 9 that requires a writing. Therefore, a right to payment of money in electronic form only will not be an instrument, and will be an account, chattel paper or general intangible. The Article 9 definition of instrument is, however, broader than that under Article 3. "Article 3 defines 'instrument' simply as 'negotiable instrument.'" See E53 Fed. Credit Union v. Perez (In Re Perez), 440 B.R. 634, 638-39 n.5 (Bankr. D.N.J. 2010). And Article 3 resolves any conflict between Article 3 and Article 9 in favor of Article 9. U.C.C. § 3-104(b).

payment arising out of the use of a credit or charge card or information contained on or for use with the card.

Note: "Except in the case of chattel paper, the fact that an instrument is secured by a security interest or encumbrance on property does not change the character of the instrument ...."[256]

(a) **Promissory Note**[257] – An instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay (i.e., check), and does not contain an acknowledgement by a bank that the bank has received for deposit a sum of money or funds. (Does not include checks, CDs or a note with a security agreement, which is chattel paper.)

(xiv) ***Investment Property***[258] – A commodity account, commodity contract,[259] a security,[260] (whether certificated or un-certificated), a security entitlement,[261] or a securities account (i.e., stock account,[262] money market account).

(a) **Broker**[263] – A person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, buys security from, or sells a security to, a customer. Nothing in this Article (Article 8) determines the

256 See U.C.C. § 9-102 cmt. 5(c).

257 U.C.C. § 9-102(a)(65).

258 U.C.C. § 9-102(a)(49).

259 Commodity futures contracts and options.

260 "Security" is defined in Article 8 of the U.C.C. U.C.C. § 8-102(15). A "security" is typically a stock or bond, certificated or uncertificated. A certificated security is represented by a "security certificate," but an uncertificated security is not a general intangible. "Security" excludes partnership interests and limited liability units. U.C.C. § 8-103(c). For an excellent discussion of the differences between an investment account and a deposit account, See In Re Gem Refrigerator Co., 512 B.R. 194 (Bankr. E.D. Pa. 2014).

261 A "security entitlement" is simply the right of the owner of an account with a broker in which there are securities. U.C.C. § 8-102(17).

262 See In Re Gem Refrigerator Co., 512 B.R. 194 (A brokerage account at Charles Schwab held to be an investment account and not a deposit account).

263 See U.C.C. § 8-102(a)(3).

capacity in which a person acts for purposes of any other statute or rule to which the person is subject.

(b) Un-certificated Security[264] – A share, participation, or other interest in property of or an enterprise of the issuer or an obligation of the issuer which is: (i) not represented by an instrument and the transfer of which is registered upon books maintained for that purpose on behalf of the issuer; (ii) of a type commonly dealt in on securities exchanges or markets; and (iii) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests or obligations.

(c) Certificated Security[265] – A share, participation, or other interest in property of or an enterprise of the issuer or an obligation of the issuer which is (i) represented by an instrument issued in bearer or registered form; (ii) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and (iii) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests, or obligations.

- "**Registered Form**"[266] – A Certificated Security is in "registered form" if: (i) it specifies a person entitled to the security or the rights it represents; and (ii) its transfer may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security so states.
- "**Bearer Form**"[267] – A Certificated Security is in "bearer form" if it runs to bearer according to its terms and not by reason of any endorsement.

(d) Commodity Account[268] – An account maintained by a commodity intermediary, in which a commodity contract is carried for a commodity customer.

264 See U.C.C. § 8-102(a)(18).
265 See U.C.C.§ 8-102(a)(4).
266 See U.C.C.§ 8-102(a)(13).
267 See U.C.C.§ 8-102(a)(2).
268 See U.C.C. § 9-102(a)(14).

(e) **Commodity Contract**[269] – A commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract option is: (a) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or (b) traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(f) **Commodity Customer**[270] – A person for which a commodity intermediary carries a commodity contract on its books.

(g) **Commodity Intermediary**[271] – A person that: (a) is registered as a futures commission merchant under federal commodities law; or (b) in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law.

(h) **Securities Account**[272] – An account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that compromise the financial asset.

(i) **Securities Intermediary**[273] – Means (i) a clearing corporation; or (ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(j) **Security Entitlement**[274] – The rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5.

(xv) ***Letter-of-Credit Right***[275] – Means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded

269 See U.C.C. § 9-102(a)(15).
270 See U.C.C. § 9-102(a)(16).
271 See U.C.C. § 9-102(a)(17).
272 See U.C.C. § 8-501(a).
273 See U.C.C. § 8-102(14).
274 See U.C.C. § 8-102(17).
275 See U.C.C. § 9-102(a)(51).

or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit. This definition is consistent with Article 5, which authorizes assignment of a beneficiary's right to the proceeds, with the consent of the issuer.[276] "Proceeds" does not include drawing rights.[277] Electronic letters of credit are included within Article 9.[278]

Note: A secured party can become a transferee of the letter of credit, instead of just a secured party, in which case, as transferee, it can obtain the right to enforce payment.[279] The rights of the transfer beneficiary are independent and superior to that of a secured party that has obtained control over a letter of credit.[280] Article 9 only applies when the assignment to the right to proceeds is for a security interest. Article 9 does not apply to a transfer of the right to draw (whether it is as a security interest or a sale.)[281]

(xvi) ***Litigation Rights*** – A breach of contract claim in litigation is likely to be a general intangible, not a commercial tort claim. Many times litigation will include contract and tort claims. If there is any doubt about the nature of the claims the secured party should be sure to comply with the specific requirements for obtaining a security interest in a commercial tort claim. See Chapter II (A) (iii) (a), supra. Of course, the secured party should also be sure to perfect against both commercial tort claims and general intangibles, including both in the financing statements. It must be further noted that once litigation is reduced to a judgment, Article 9 does not apply to the assignment of an interest in a judgment unless the original collateral was the right to the proceeds of the litigation. Finally, if the claim in the litigation was not a commercial tort or breach of

276 See U.C.C. § 5-114(c).

277 See U.C.C. § 5-114(a).

278 See U.C.C. §§ 9-102a)(77) and 9-203.

279 See U.C.C. §§ 9-329 cmt. 4, 5-114. A letter of credit is not transferrable unless its expressly so provides. U.C.C. § 5-116(1); U.C.P. art. 38; ISP98 Rule 6.02(a). But see FDIC v. Bank of Boulder, 911 F.2d 1466 (10th Cir. 1990), cert. denied, 499 U.S. 904 (1991) (certain FDIC assignments excepted based on Federal preemption). However, even if the letter is not transferrable a lender may, with the consent of the issuer, still take an assignment of the monies payable under the letter. U.C.C. § 5-114; U.C.P. art. 49; ISP98, Official Comment to Rule 6.06.

280 See U.C.C. § 9-329 cmt. 4.

281 See U.C.C. § 5-114.

contract claim, but was a personal injury claim, it could not have been the subject of an original collateral claim and can only become subject to Article 9 when and if the claim is settled and becomes an obligation to pay, at which time it is a payment intangible. See U.C.C. § 9-109, Comment 15. Thus, a secured party cannot obtain a security interest under Article 9 in a personal injury case unless and until it has settled and become an obligation to pay. And a secured party cannot obtain a security interest in a judgment unless it is the result of an original collateral claim or it has been settled and become an obligation to pay.

(xvii) ***Lottery Prizes*** – See accounts.

(xviii) ***Proceeds*** – Means the following property: whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral; whatever is collected on, or distributed on account of, collateral; rights arising out of collateral; to the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or to the extent of the value of the collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.[282]

(xix) ***Software***[283] – Computer program and any supporting information. The term does not include a computer program that is embedded in goods. If the computer program is embedded in goods, the collateral is then treated as goods for all purposes. Software is embedded if "(i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires the right to use the program in connection with the goods."[284] The software is not to be deemed part of the "goods" if the software is "embedded in goods that consist of solely of the medium in which the program is embedded." Id. Thus, the software that runs various aspects of a car is embedded in

282 See U.C.C. § 9-102(a)(64). See also Footnote 43, supra, regarding insurances monies and lawsuits for damage or destruction of collateral as "proceeds."

283 See U.C.C. § 9-102(a)(75).

284 See U.C.C. § 9-102(a)(44).

such a way that it is not separate collateral from the car, the car and the software together are "goods." Conversely, a desktop computer and its operating system are not one, but two separate categories of collateral, namely goods and software (general intangible).

Note: Trade secrets and intellectual property rights in connection with software are general intangibles. Revenues from the sale or license of software are accounts or proceeds of copyrights or patents.

(xx) ***Supporting Obligations***[285] – A letter-of-credit right or secondary obligation that supports payment or performance of an account, chattel paper, a document, a general intangible, an instrument or investment property.

(xxi) ***Title Vehicles***[286] – Motor vehicles subject to a Certificate of Title Statute. "Certificate of Title" means "a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral."[287]

(xxii) ***Timber To Be Cut*** – See Goods, supra.

(xxiii) ***Virtual Currencies*** – A distinction must be noted between virtual currency and real currency. Real currency is "coin and paper money of the United States and any other county that is designated as legal tender, circulates and is customarily used and accepted as a medium of exchange in the country of issuance." Virtual currencies do not have legal tender status.[288]

(xxiv) ***Non-uniform Amendments*** – Some states have created special classes of collateral through non-uniform amendments. For example, New York has created a class for "cooperatives," through a 1988

285 See U.C.C. § 9-102(a)(78).

286 Titled Vehicles can also be inventory. See Chapter III, (B), (xxxiv) (Titled Vehicles subsection) infra.

287 See U.C.C. § 9-102(a)(10).

288 Financial Crimes Enforcement Network ("Fin Cen."), Guidance, FIN-2013-G-0001, 3/18/13.

non-uniform amendment, which was incorporated into the 2001 revisions.[289] The amendment requires a "cooperative addendum" to be filed with the financing statement.[290]

(B) How to Perfect In Various Types of Collateral

Applicable Law – Generally, the law of the jurisdiction in which the debtor is "located" governs perfection, the effect of perfection or nonperfection, and priority.[291] Where, however, perfection is effected through possession, the law of the jurisdiction in which the collateral is located governs perfection, the effect of perfection or nonperfection, and priority.[292] But for non-possessory security interests in negotiable documents, goods, instruments, money or tangible chattel paper, the local law of the jurisdiction only governs perfection for goods of fixtures and timber to be cut, and the local law governs the effect of perfection or nonperfection and the priority of nonpossessory security interests in collateral.[293] With respect to deposit accounts, the local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection, and priority.[294] The situs of the bank's "jurisdiction" may be agreed between the parties in their agreement.[295] The rule is somewhat similar for investment accounts.[296] The governing law for letters of credit is generally the issuer's jurisdiction or a nominated person's jurisdiction.[297] With the exception of deposit

289 See Special definition of cooperative interests. N.Y. U.C.C. §§ 9-611 (F) and 9-102(a)(27-a)–(27-f) and § 9-501. Even a PMSI perfected secured creditor in a N.Y. cooperative may be trumped by maintenance charges and late fees. In Re McCoy, 496 B.R. 678 (Bankr. E.D.N.Y. 2011).

290 Special information must be spelled out in the amendment. N.Y.U.C.C. § 9-502(e). When the Financing Statement Cooperative addendum is filed it is valid for 50 years. There are also special notice rules for foreclosing the security interest (90 days' notice required) and for terminating the security interests. N.Y. U.C.C. § 9-513.

291 See U.C.C. § 9-301(1); Mull Drilling Co. v. SemCrude, L.P. (In Re SemCrude, L.P.), 407 B.R. 82 (Bankr. D. Del. 2009) (Texas oil and gas producers' perfection under Texas non-uniform amendment to Article 9 subordinate to banks that filed financing statements in Delaware).

292 See U.C.C. §§ 9-301(2), 9-301(3)(A) and (B).

293 See U.C.C. § 9-301(3), except as to a wellhead, or minehead, and for priority, to as-extracted collateral. "The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral." U.C.C. § 9-301(4).

294 See U.C.C. § 9-304(a).

295 See U.C.C. § 9-304(b)(1).

296 See U.C.C. §§ 9-305 and 8-110(e).

297 See U.C.C. § 9-306. This section does not apply when the security interest in the letter of credit is perfected only as a supporting obligation. Id. at § 9-306(c).

accounts and investment accounts, the Article 9 rules governing perfection and priority apply independently of any contractual law provisions because the parties may not contractually modify the rights of third parties such as other secured creditors.[298]

Notably, "[i]n designating the jurisdiction whose law governs, [Article 9] directs the court to apply only the substantive ("local") law of a particular jurisdiction and not its choice-of-law rules."[299]

A security interest in each of these categories may be perfected as follows:

(i) ***Account:*** Filing. U.C.C. § 9-310(a).

Exception: Accounts that are not a significant part of outstanding accounts: Perfection is automatic. § 9-309(2).

(1) Health care insurance receivables assigned to provider of health care goods or services: Perfection is automatic. § 9-309(5).

(ii) ***Agricultural Liens:*** Filing. U.C.C. § 9-310(a).

(iii) ***Annuity Contracts:*** If not insurance policy, annuities are general intangibles. See General Intangibles, infra.[300]

(iv) ***Assignments For the Benefit of Creditors:*** § 9-309(12).

(v) ***As-Extracted Collateral:*** Filing. Note that the filing, like a fixture filing, must be made with the office in which a mortgage would be filed on the real estate and must include additional information. U.C.C. § 9-310(a); U.C.C. §§ 9-501(a)(1)(a) and 9-502(b).

298 The parties may, however, choose the applicable law governing remedies and enforcement, since these don't affect third-party rights. Indeed, under U.C.C. § 9-603 "the parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party ... if the standards are not manifestly unreasonable."

299 See U.C.C. § 9-301 cmt. 3.

300 See In Re Custom Coals Laurel, 258 B.R. 597 (Bankr. W.D. Pa. 2001); Knostman v. W. Loop Sav. Ass'n (In Re Newman), 993 F.2d 90 (5th Cir. 1993); In Re Hayes, 168 B.R. 717, 724-25 (Bankr. D. Kan. 1994).

(vi) ***Certificate of Deposit ("CD"):*** A CD is generally either a deposit account or an instrument, depending upon whether it is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment. If the CD is so transferrable in the marketplace it is an instrument, even if the language on it states otherwise.[301] If the CD is not transferrable by delivery with any necessary endorsement or assignment, it should be a deposit account.[302] See Instruments and Deposit Accounts, infra.

(vii) ***Chattel Paper:*** Filing or possession. U.C.C. §§ 9-312(a), 9-313(a).

PRACTICE TIP: If a secured party chooses to perfect through filing instead of possession, it is at risk of losing its priority unless the chattel paper is "marked" to evidence the secured party's security interest. See ***U.C.C. § 9-330(a), (b) and (f). The secured party will, however, prevail over a trustee in bankruptcy with just a filing. U.C.C. §§ 9-312(a), 9-330.***

(1) Electronic Chattel Paper: Filing or control. U.C.C. §§ 9-312(a), 9-314(a) and 9-105.

(viii) ***Commercial Tort Claim:*** Filing. U.C.C. § 9-310(a).[303]

---

301 Omega Envtl. Inc. v. Valley Bank NA, 219 F.3d 984 (9th Cir. 2000); Cadle Co. v. Citizens Nat'l Bank, 200 W. Va. 515, 490 S.E.2d 334 (1997).

302 See E53 Fed. Credit Union v. Perez (In Re Perez), 440 B.R. 634 (Bankr. D.N.J. 2010).

303 Recall that the security agreement must specifically describe the litigation except to the extent the tort claim is proceeds of original collateral, and may not be the subject of an after acquired provision. U.C.C. § 9-108(e)(1). A breach of contract claim in litigation is likely to be proceeds of an account or a general intangible, not a commercial tort claim. Many times litigation will include contract and tort claims. If there is any doubt about the nature of the claims the secured party should be sure to comply with the specific requirements for obtaining a security interest in a commercial tort claim. See Chapter II (A) (iii) (a), supra. Of course, the secured party should also be sure to perfect against both commercial tort claims and general intangibles, including both in the financing statements. It must be further noted that once litigation is reduced to a judgment, Article 9 does not apply to the assignment of an interest in a judgment except as proceeds of original collateral. Finally, if the claim in the litigation was not a commercial tort or breach of contract claim, but was a personal injury claim, it cannot be the subject of an original collateral claim and can only become subject to Article 9 when and if the claim is settled and becomes an obligation to pay, at which time it is a payment intangible. See U.C.C. § 9-109, Comment 15. Thus, a secured party cannot obtain a security interest under Article 9 in a personal injury case unless and until it has settled and become an obligation to pay. And a secured party cannot obtain a security interest in a judgment unless it is the result of an original collateral claim or it has been settled and become an obligation to pay.

(ix) ***Consignment:*** Filing and Notice for inventory. U.C.C. §§ 9-310(a) and 9-324(b). Consignments are often inventory under Article 9, and thus, a secured party must be sure not only to perfect its position but also to it comply with the inventory special timing and notice provisions.

(x) ***Copyrights:*** Unregistered Copyrights are general intangibles.[304] Filing. U.C.C. § 9-310(a). Registered Copyrights are not general intangibles and are governed by federal law.[305] For Registered Copyrights, a "note" or "memorandum" must be filed in the U.S. Copyright Office. The secured party would be wise to file a financing statement as well.

(xi) ***Crops:*** Filing or Possession. See Goods, infra.

Note: While "crops" do not require a county filing, like a fixture filing, "timber" does require such a filing. See Goods, Standing Timber, infra.[306]

(xii) ***Deposit Account:*** Control under U.C.C. § 9-104, 9-314(a).

(1) Secured Party is Depository Bank: When the secured party is the depository bank it is automatically deemed to be in control and, thus, perfected. U.C.C. § 9-104(a)(1).

(2) Secured Party is not Depository Bank: When the secured party is not the depository bank, the secured party, the debtor and the bank must enter into a control agreement, U.C.C. § 9-104(a)(2), or the secured party must become the customer on the account. U.C.C. § 9-104(a)(3).

PRACTICE TIP: Due to depository bank's "secret lien," even when a secured party (non-depository bank) obtains a control agreement, it should also obtain a waiver

304 See In Re World Auxiliary Power Co., 303 F.3d 1120 (9th Cir. 2002).

305 See 17 U.S.C. §§ 204, 205. See 17 U.S.C. § 101. See also In Re Peregine Ent't, Ltd., 116 B.R. 194 (C.D. Cal. 1990). The secured party should file the security agreement or a "note or memorandum" of the security interest or mortgage of copyright. 17 U.S.C. § 204. This "note" or "memorandum" should contain the title of the copyright work, the registration number, name and address of the secured party and the notarized signature of the debtor. If the copyright is not registered, perfection is under Article 9. In Re World Auxiliary Power Co., supra. The secured party should, however, register the copyright and then file against it.

306 Crops are a sub-category of "goods." U.C.C. § 9-102(a)(44).

from the depository bank of its right of setoff or recoupment and obtain a subordination from the depository bank or become the bank's customer. **See** ***Priority in Liens section,*** **infra.**

(xiii) ***Documents*:**

(1) **Negotiable:** Filing or Possession. U.C.C. §§ 9-312(a), 9-313(a). A document is "negotiable" if, by its terms, the goods are to be delivered to bearer or to the order of a named person. U.C.C. § 7-104(1)(b). All other documents are non-negotiable. Under California law, however, any non-negotiable document must be conspicuously marked as "non-negotiable" or the holder who purchased it for value with the understanding it was negotiable may treat it as negotiable as to a bailee.[307]

(2) **Goods covered by negotiable document:** While goods are in the possession of a bailee that has issued a negotiable document covering the goods, a secured party may perfect a security interest in the goods by perfecting a security interest in the document. A security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.[308]

PRACTICE TIP: A secured party that perfects through filing only risks losing its priority to one who subsequently takes possession. The secured party will, however, prevail over a trustee in bankruptcy with just a filing. U.C.C. § 9-312(a).

(3) **Non-Negotiable:** Issuance of document in name of secured party; bailee's receipt of notification; or filing as to goods. *U.C.C. §* 9-312(d).

- Goods covered by non-negotiable document - While goods are in the possession of a bailee that has issued a non-negotiable document covering the goods, a security interest in the goods may be perfected by:
  - (3.a.1) Issuance of a document in the name of the secured party;
  - (3.a.2) The bailee's receipt of notification of the secured party's interest; or
  - (3.a.3) Filing as to the goods.[309]

307 Cal. Com. Code § 7104(c) (2007).

308 See U.C.C. § 9-312(c)(1) and (2).

309 See U.C.C. §§ 9-312(d)(1)-(3).

Note: Documents contain two of Article 9's few secret/temporary liens. First, with negotiable documents, instruments and certificated securities, a secured party that gives new value pursuant to a written security agreement has a perfected lien for twenty (20) days without filing. U.C.C. § 9-312(e). Second, with negotiable documents or goods in possession of a bailee without a negotiable document, the security interest remains perfected even when the secured party gives the debtor the goods or the documents representing the goods for the purpose of ultimate sale or exchange or loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange. U.C.C. § 9-312(f)(1) and (2).

PRACTICE TIP: With goods in possession of a bailee with a non-negotiable document, the secured party should: (1) file as to the goods; (2) notify the bailee of the secured party's interest; or (3) arrange for a document to be issued in name of secured party. U.C.C. § 9-312(d).

(xiv) ***Estates:*** Automatic. U.C.C. § 9-309(13).

PRACTICE TIP: Notify the executor or administrator and obtain an acknowledgement of notification of the lien. A secured party with an interest in the estate should have the debtor sign a security agreement before a notary to assure priority. Remember there may be prior, unknown, liens because perfection is automatic.

(xv) ***Fixtures:*** Filing. Note that with the exception of Louisiana[310] a "fixture filing" must be made with the office in which a mortgage would be filed on the real estate and must include additional real property related information. U.C.C. §§ 9-310(a), 9-501(a)(1)(B) and 9-502(b).[311] A mortgage that satisfies the requirements of Section 9-502(c) is also effective as a fixture filing. A filing for certain trade fixtures, readily removable equipment and machinery does not need to be filed in the office in which a mortgage must be filed: A regular, centrally filed financing statement is sufficient. U.C.C. § 8-334(e)(2). Thus,

310 In Louisiana, a fixture filing must meet all of the requirements of Section 9-502(a) and (b) but it need only be filed in the regular U.C.C. index, not the real property records.

311 Note that while a creditor may obtain a PMSI in Fixtures, the 20-day grace period for filing does not trump a filing within the 20-day period and the PMSI will also not trump a construction mortgage or a permanent mortgage refinancing a construction mortgage. See Chapter IV, (J), infra.

there are three ways to file against fixtures. For non-trade fixtures, a fixture filing or mortgage satisfying the requirements of U.C.C. § 9-502(c) must be filed. For certain trade fixtures, an ordinary filing is all that is required.

(xvi) ***Franchise Agreements:*** Franchise Agreements are general intangibles.[312] See General Intangibles, infra.

(xvii) ***General Intangibles*****:** Filing. U.C.C. § 9-310(a).[313]

PRACTICE TIP: Real Estate Related Contracts: Article 9 does not apply to real estate, but applies to promissory notes related to real property. U.C.C. §§ 9-109(d)(11)(A), 9-203(g) and 9-308(e). General intangibles may include other real estate contracts such as purchase sale contracts, option contracts, licenses and permits. If these documents are not pure real estate contracts, they may be considered "accounts." Accordingly, it is prudent in these cases to record a real property assignment and file a financing statement.

PRACTICE TIP: Copyrights, Patents and Trademarks: As noted in this section and in Chapter I, supra, Article 9 does not apply to registered copyrights but does apply to unregistered copyrights, patents and trademarks. As is also noted above in this section and in Chapter I, unregistered copyrights should generally be registered and then filed against at the federal level. Federal filings should also be made against

312 See BMW Fin. Servs., NA, LLC v. Rio Grande Valley Motors, Inc., 2012 WL 4623198 (S.D. Tex. Oct. 1, 2012); Thomas C. Thompson Sports, Inc. v. Farmers & Merch. Bank (In Re Turley), 172 F.3d 671 (9th Cir. 1999); In Re Topsy's Shoppes, Inc., 131 B.R. 886, 888 (D. Kan. 1991); In Re Gordon Car & Truck Rental Inc., 80 B.R. 12 (N.D.N.Y. 1987); In Re Hengalo Enters., 51 B.R. 54 (S.D. Fla. 1985). Payment for termination of a franchise agreement is within the definition. In Re SRJ Enters., 150 B.R. 933 (N.D. Ill. 1933).

313 As LLC and partnership interests may not be securities under Article 8, the best practice is to file and take possession of the certificate (if one exists) with an assignment executed in blank by the debtor. Transfer restrictions in an LLC or partnership interest may be problematic. If the LLC or partnership is an Article 8 security the Article 9 anti-assignment provisions of §§ 9-406 and 9-408 don't apply, and even if the interest is an Article 9 interest, the anti-assignment provisions have a limited application in the case of general intangibles that are not payment intangibles. Moreover, the anti-assignment provisions only override provisions between the debtor and an account debtor, not third parties such as another member or partner. Thus, the secured party needs to get waivers all around, and it should include the right of a foreclosure assignee to be admitted to the LLC or partnership. The LLC or partnership should further acknowledge the security interest and agree to pay all distributions payable to debtor to the secured party at the outset or later upon secured setoff claims. U.C.C. §§ 9-404(a)(2), 9-406(a).

patents and trademarks. See Copyrights, Trademarks and Patents within this section and Chapter I (B) Copyrights, Trademarks and Patents and Footnotes 21 – 27, supra.

(1) Payment Intangibles

- Sale: Perfection is automatic. U.C.C. § 9-309(3).
- Payment intangible that is not a significant part of payment intangibles:
- Perfection is automatic. U.C.C § 9-309(2).
- Pledge: Filing. U.C.C. § 9-310(a).

(xviii) ***Goodwill:*** Goodwill is a general intangible.[314] See General Intangibles, supra.

(xix) ***Goods:***

(1) Accession: Filing or Automatic. U.C.C. § 9-310 (a); U.C.C. § 9-335 (a) and (b).

(2) Consumer Goods: Filing or Possession. U.C.C. § 9-310(a); U.C.C. § 9-313(a).[315]

Exceptions:

- PMSI: Perfection is automatic. U.C.C. § 9-309(1).
- Assets subject to title statutes which are not inventory: See Titled Vehicles, infra.

(3) Crops: Filing or Possession U.C.C. §§ 9-310(a), 9-313(a). Agricultural lenders must also be familiar and comply with the Federal Food Security Act. [316]

(4) Equipment: Filing or Possession. U.C.C. §§ 9-310(a), 9-313(a).

(5) Farm Products:[317] Filing or Possession, with Notice for PMSI in livestock. U.C.C. §§ 9-310(a), 9-313(a), 9-324(d).

314 See Waltrip v. Kimberlin, 164 Cal. App. 4th 517, 521 (2008); Cal. Wholesale Material Supply, Inc. v. Norm Wilson & Sons, 96 Cal. App. 4th 598, 605 (2002); In Re Leasing Consultations, Inc. 486 F.2d 367, 371 n.5 (2d Cir. 1973); Bank of Wash. v. Burgraff, 38 Wash. App. 492, 687 P.2d 236 (1984).

315 As discussed in the Transformation Doctrine subsection of the PMSI section of the Priority in Liens Chapter infra, Article 9 does not preclude application of the transformation doctrine in consumer transactions. The secured party should avoid cross-collateralization of a PMSI and new advances secured by a PMSI in consumer transactions.

316 See 7 U.S.C. § 1631 et al.

317 Special notice and other steps must be taken to perfect a PMSI in livestock that are farm products. See Obtaining a PMSI in livestock that are farm products subsection of Chapter IV section, infra.

(6) **Inventory:**[318] Filing or Possession, with Notice for PMSI. U.C.C. §§ 9-310(a), 9-313(a), 9-324(b).

PRACTICE TIP: As noted in the Documents section, supra, while goods are in the possession of a bailee a security interest in the goods may be perfected through perfection in the documents.

(7) **Manufactured Homes:** Filing. The filing can be effective for up to 30 years. U.C.C. §§ 9-310(a), 9-515(b).

Exception – If state law requires a certificate of title for ownership, perfect the security interest by filing against the title. A security interest perfected under a state title statute has priority over the interests of an owner or lienholder of the real property. U.C.C. § 9-334(e)(4).

(8) **Standing Timber:** (To be cut and removed under a conveyance or contract for sale). Filing and Fixture Filing U.C.C. §§ 9-310(a) and 9-502(b).

Note: Unlike "crops", "standing timber" requires a financing statement to be filed at the county level as well, much like a fixture filing. Standing timber, "timber to be cut" is treated like a security interest related to real property.

PRACTICE TIP: When completing the UCC-1 form check and complete the fixture box, item 13 and the manufactured home box, item 18.

(xx) ***Income Tax Refund:*** Income tax refunds are general intangibles.[319] See General Intangibles, supra.

(xxi) ***Instrument:*** Filing or possession. U.C.C. §§ 9-312(a), 9-313(a). Temporary automatic, U.C.C. § 9-312(e) (new value) or § 9-312(g) (when made available

318 To the extent inventory is in transit and becomes the subject of bills of lading, warehouse receipts or other documents, the secured party may also perfect the security interest in the documents. See Perfection in Documents, supra. This lien is superior to a lien perfected in the goods by another means so long as the goods are in the possession of the bailee that issued the negotiable documents. U.C.C. § 9-312(c)(2). Special steps must be taken to perfect a PMSI in inventory. See Obtaining a PMSI in Inventory subsection of Priority in Liens section, infra. Titled vehicles can also be inventory, in which case the secured party must perfect its lien under Article 9 instead of the state Certificate of Title law. See Titled Vehicles subsection, infra.

319 See BancorpSouth Bank v. Hazelwood Logistics Ctr., LLC, 2011WL 5900998 (E.D. Mo. Nov. 23, 2011). In contrast, tax credits are not considered general intangibles. See City of Chi. v. Mich. Beach Hous. Coop., 242 Ill. App. 3d 636, 645-46, 609 N.E.2d 877, 885 (1993).

to the debtor for sale or exchange or presentation, collection, enforcement, renewal or registration of transfer).

PRACTICE TIP: A secured party that perfects on an instrument through filing only risks losing its priority to one who subsequently takes possession, unless the instrument is "marked" to evidence the secured party's security interest. U.C.C. § 9-330 (d) and (f). The secured party does, however, prevail over a trustee in bankruptcy with just a filing. U.C.C. §§ 9-312(a), 9-330.

(1) Promissory Note

- **Sale**: Perfection is automatic.[320]
- **Pledge**: Filing or Possession. U.C.C. §§ 9-312(a), 9-313(a).

Note: One should generally not perfect by filing only because you (1) cannot sue without possession of note; and (2) cannot be holder in due course without possession.

PRACTICE TIP: Two important concepts must be noted in connection with promissory notes and mortgages. First, the mortgage follows the note.[321] Second, because the mortgage follows the note, Article 9 trumps real estate mortgage law regarding priority of liens.[322] Thus, where a note and mortgage were double pledged, and creditor A perfected under Article 9 by taking possession of the original note and filing a UCC-1 and creditor B perfected by filing a notice of the assignment of the mortgage in the real property records, creditor A had priority in the note and mortgage.[323] Accordingly, when taking a lien in a note and mortgage, perfection under Article 9 is paramount, even though the mortgage clearly is an interest in real property.

(xxii) ***Investment Property:***[324]

320 See U.C.C. § 9-309(4).

321 In Re HW Partners, LLC, 2013 WL 4874172 (Bankr. E.D. Wash. Sept. 12, 2013).

322 Id.

323 Id.

324 As set forth in Section III (A)(iii)(a), supra, the description of the collateral may be general, except in consumer cases. U.C.C. § 9-108.

(1) **Certificated Securities:** Temporary automatic,[325] possession,[326] control[327] or filing.[328]

Note: Certificated Securities contain two of Article 9's few secret/temporary liens. First, with negotiable documents, instruments and certificated securities, a secured party that gives new value pursuant to a written security agreement has a perfected lien for twenty (20) days without filing. U.C.C. § 9-312(e). Second, with a certificated security or instrument, a perfected security interest remains perfected for twenty days without filing where the secured party delivers the security certificate or instrument to the debtor for the purpose of: (1) sale or exchange; or (2) presentation, collection, enforcement, renewal, registration or transfer. U.C.C. § 9-312(g)(1) and (2).

(2) **Uncertificated Securities:** Filing or control. U.C.C. §§ 9-312(a), 9-314(a), 9-106, 8-106.

Note: The stock of a public company held by a clearing house, an open end mutual fund and U.S. Treasury Securities are all generally un-certificated and held by third-parties and thus, may also generally be perfected by filing or control. Of course, once again, control trumps filing.

(3) **Securities Account/Commodity Account:** Filing or control. U.C.C. §§ 9-312(a), 9-314(a), 9-106, 8-106.
(4) **Securities Entitlements (carried in securities account):** Perfection is automatic upon perfection in security account. U.C.C. § 9-308(f).
(5) **Commodity Contract (carried in commodities account):** Perfection is automatic upon perfection in a commodity account. U.C.C. § 9-308(g).
(6) **Security Interest created by broker or intermediary:** Perfection is automatic. U.C.C. §§ 9-309(10), (11).

PRACTICE TIP: A secured party that perfects on investment property through filing only risks losing its priority to one who subsequently obtains possession or control, and

325 For new value, U.C.C. § 9-312(e), or when made available to debtor under § 9-312(g).

326 See U.C.C. §§ 9-313(a), 8-106, 8-301. If there are to be two liens, the pledgee must acknowledge that it holds for the second lien holder's benefit. U.C.C. § 9-313(c)(1).

327 See U.C.C. §§ 9-314(a), 9-106, 8-106.

328 See U.C.C. § 9-312(a). This section does not apply if the debtor is a broker or securities intermediary.

is not protected against adverse claims under Article 8 of the U.C.C. The secured party does, however, prevail over a trustee in bankruptcy with just a filing. U.C.C. § 9-312(a).

Note: See Perfecting through Control, infra, for additional information regarding perfecting in Investment Property through control.

(xxiii) ***Letter-of-Credit Right*:** Control under U.C.C. § 9-107 or automatically as a supported obligation. U.C.C. §§ 9-314(b), 9-308(d).[329]

(xxiv) ***Liquor License***: Liquor licenses are general intangibles but may not be subject to a lien, depending on state law. See General Intangibles, subsection A (xi) (a), supra.

(xxv) ***Litigation Claims (and Settlements)*:** A breach of contract claim in litigation is likely to be proceeds of an account or a general intangible, not a commercial tort claim. Many times litigation will include contract and tort claims. If there is any doubt about the nature of the claims the secured party should be sure to comply with the specific requirements for obtaining a security interest in a general intangible and a commercial tort claim. See Chapter II (A) (iii) (a), supra. Of course, the secured party should also be sure to perfect against both commercial tort claims and general intangibles, including both in the financing statements. It must be further noted that once litigation is reduced to a judgment, Article 9 does not apply to the assignment of an interest in a judgment unless it is proceeds of original collateral. If the claim in the litigation was not a commercial tort or breach of contract claim, but was a personal injury claim, it could not have been the subject of an original collateral claim and can only become subject to Article 9 when and if the claim is settled and becomes an obligation to pay, at which time it is a payment intangible. See U.C.C. § 9-109, Comment 15. Thus, a secured party cannot obtain a security interest under Article 9 in a personal injury case unless and until it has settled and become an obligation to pay, such as a structured settlement. Two significant issues arise in connection with the sale or pledge of structured settlements. First, under the free alienability rules of 9-408, a contract provision barring the pledge or assignment should

329 If the secured party relies upon automatic perfection in the letter of credit as a supporting obligation, a third party that perfected a lien in the letter of credit by obtaining the issuing bank's consent to the assignment of proceeds will have priority.

not stop the pledge or assignment. Enforcement by the assignee may be more problematic, however, because under 9-406 (e), in the case of an outright sale of a payment intangible the obligations of an account debtor to pay an assignee upon notice under 9-406 (a), does not apply. Other contractual restrictions on enforcement valid under non-Article 9 law may also apply. Second, while perfection would be automatic under Article 9-309(3) in the case of an outright sale, a financing statement would need to be filed in the case of a pledge. Like lottery prizes, however, many states have legislation requiring a court order for the sale of structured settlements.[330] Finally, a secured party cannot obtain a security interest in a judgment unless it is the result of an original collateral claim or it has been settled and become an obligation to pay.

(xxvi) ***Lottery Prizes*****:** Filing U.C.C. § 9-310(a).[331] Tex. Lottery Comm'n v. First State Bank of DeQueen, 254 S.W.3d 677, 65 U.C.C. Rep. Serv. 2d 755 (Tex. App. 2008) (court allowed lottery winner to sell right to installment payments despite state law barring sale). Federal and state statutes intended to survive Article 9, however, override Article 9. U.C.C. § 9-109(c). See, Stone Street Capital, LLC v. Cal. State Lottery Comm'n, 80 Cal. Rptr. 3d 326, 66 U.C.C. Rep. Serv. 2d 206 (Cal. Ct. App. 2008); Wolf v. Brach, 660 N.Y.S. 2d 430 (1997).

(xxvii) ***Money*****:** Possession under U.C.C. §§ 9-313, 9-312(b)(3).

(xxviii) ***Mortgage*****:** Perfection in the promissory note creates an automatic perfection in the mortgage, as a supported obligation. U.C.C. § 9-308(e).

---

330 See Henderson Receivables Origination LLC v. Sioteco, 173 Cal. App. 4th 1059 (Cal. Ct. App. 2009).

331 If the secured party doesn't take a traditional security interest in the lottery winnings, but rather buys the stream of payments at a discount perfection is automatic if the applicable jurisdiction is one which adopted the amendment to subsection 14, § 9-309. The secured party, however, needs to determine the seller's residence and file a financial statement if the borrower's residence is one of the dozens of jurisdictions that has not yet adopted the curative amendment to U.C.C § 9-309. The secured party will also then need to monitor changes in the debtor's location and do additional filings within four months of any move by an individual debtor.

(xxix) ***Patents*:** Patents are general intangibles under Article 9.[332] Filing U.C.C. § 9-310(a). The Patent Act, arguably only requires filings at the federal level for transfers of ownership.[333] The secured party should, however, file a "conditional assignment" with the Commissioner of Patents and Trademarks, as well as an Article 9 Financing statement. [334]

(xxx) ***Proceeds*:** Automatic for 20 days. U.C.C. § 9-315 (c) and (d). U.C.C. § 9-203(f). The lien continues beyond 20 days if:

(1) The following conditions are satisfied:

(a) A filed financing statement covers the original collateral;

(b) The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and

(c) The proceeds are not acquired with cash proceeds.

(2) The proceeds are identifiable cash proceeds;

(3) Security interest attaches to the proceeds or within 20 days thereafter.

PRACTICE TIP: Number 3 above can often be invoked by a Secured Creditor with an "all asset" financing statement, such as where a debtor sells inventory, deposits the money into a deposit account and then writes a check to purchase equipment. A secured creditor with less than an "all asset" filing, however, is not likely to be as lucky. The non "all asset" secured party should be sure to include "proceeds" language in its financing statement, to maximize its ability to invoke the third prong above.

332 See Moldo v. Matsco (In Re Cybernetic Servs., Inc.), 252 F.3d 1039 (9th Cir. 2001).

333 See 35 U.S.C. § 101 et seq. (2012). See also In Re Cybernetic Servs., supra.

334 See 5 U.S.C. § 261 contemplates that "an assignment, grant or conveyance" or "mortgage" of patents (and patent applications) be filed with the U.S. Patent and Trademark Office. See 37 C.F.R. § 3.11-24. The assignment should identify the application with the patent number, date and title of invention. For a pending patent application, give the serial number, date of application and title of invention. If there is not yet a serial number, describe the application, date of the filing, inventor's name and title of invention. Also include the name and address of the secured party. The debtor's signature should be notarized. The secured party should periodically amend to include new patents and patent applications. However, if the secured party filed on a patent application that is pending, it need not file again when the patent is issued. A secured party in a patent that perfects through a financing statement only will not be protected against a bona fide purchaser who buys without knowledge of the security interest.

(xxxi) ***Royalty Payments*:** Royalty payments are general intangibles.[335] See General Intangibles, supra.

(xxxii) ***Software*:** Filing. U.C.C. § 9-310(a).

(xxxiii) ***Supporting Obligations*:** Perfection is automatic upon perfection in the supported obligation. U.C.C. § 9-308(d). U.C.C. § 9-203(f).

(xxxiv) ***Titled Vehicles*:** Lien noted on certificate of title,[336] unless vehicle is inventory, in which case perfection must be in accordance with the inventory requirements of Article 9, including notice and filing. (See Inventory

335 See Smith v. Iron & Glass Bank (In Re SSE Int'l Corp.), 198 B.R. 667 (Bankr. W.D. Pa. 1996); In Re Wilcox, 1988 WL 391225 (Bankr. N.D. Ohio Sept. 7, 1998).

336 A notation on the title that the secured party is the owner, as opposed to a lienholder, is generally adequate to perfect a lien under Article 9. In Re Circus Time, Inc., 641 F.2d 39 (1st Cir. 1981); contra In Re Otasco, 111 B.R. 976 (Bankr. N.D. Okla. 1990), rev'd, 196 B.R. 554 (N.D. Okla. 1991) (court found true lease as opposed to lease disguised as a security interest). Perfection in a new car purchased from inventory may also be through possession of an MCO (Manufacturer's Certificate of Origin). In Re Zysset, 2008 WL 4283131 (D. Neb. Sept. 11, 2008) (under Nebraska title statute, bank held to have been perfected in vehicle once bank had possession of loan documents and MCO). Where more than one state has issued a title, "the majority view is that if a security interest is perfected under the law of the jurisdiction in which it attaches, its priority cannot be defeated by the unauthorized securing of a „clean' certificate of title in another jurisdiction." Brenner Fin., Inc. v. Cinemacar Leasing, 2012 WL 1448048 (N.J. Super. Ct. App. Div. April 27, 2012) (citing IAC, Ltd. v. Princeton Porsche-Audi, 75 N.J. 379, 382 A.2d 1125 (1978)). The 2010 Amendments to Article 9 went into effect in most states July 1, 2013. The 2010 Amendments modify the definition of a "certificate of title" to include state systems that permit or require electronic records of title. As for commercial trucks operating under an ICC permit, federal law defers to the state certificate of title laws. 49 U.S.C. § 14301. In those states where the only way to search a vehicle for liens is to search by VIN, a one digit error can be fatal to the perfection of the lien. In Re Gregory, 97 P.3d 639 (Okla 2004).

under Goods, supra.)[337] U.C.C. § 9-311(a)(2), except when covered by U.C.C. §§ 9-313(b), 9-316(d): Possession.

(xxxv) ***Timber To Be Cut*:** Filing and local filing. See Goods, supra.

(xxxvi) ***Trademark*:** Trademarks are general intangibles.[338] Filing. U.C.C. § 9-310(a). The Lanham Act, like the Patent Act generally requires filings at the Federal level for transfer of ownership.[339] The secured party should,

337 See U.C.C. § 9-311(d). In Re Moye, 2008 WL 4179239 (Bankr. S.D. Tex. Aug. 29, 2008) (lender must file a financing statement and may not perfect on titled vehicles held in inventory by possession of titles). Titled vehicles are deemed "inventory": "during any period in which collateral subject to a [state Certificate of Title Law] is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods...." U.C.C. § 9-311(d). Thus, in order to be inventory, the debtor must not only hold the vehicle for sale or lease or lease the vehicle with the debtor as lessor, but in the latter case the debtor must also be in the business of selling such goods. In four states, however (Idaho, Illinois, Louisiana and Rhode Island), the vehicles are inventory if they are held by the debtor as lessor, and the debtor is in the business of selling "or leasing" goods of that type. These states adopted an older, and since abandoned version of § 9-311(d), and consequently their definition of inventory is broader than intended. Thus, in these four states titled vehicles will be deemed inventory where the debtor is a holding company that owns the vehicles and leases them to an operating company even though the debtor does not sell vehicles. Missouri had also adopted the old version of the law, but amended its statute effective August 28, 2012. Finally, determining whether vehicles are held as inventory may not always be so easy. See, e.g., Union Planters Bank v. Peninsula Bank, 897 So.2d 499 (Fla. Dist. Ct. App. 2005) (Vehicles not "inventory" where car rental company that sold approximately 4,000 vehicles per year, earning 60-70% of its revenues in this manner, where company only sold vehicles after they were 9-10 months old when they were no longer of value to the rental business, and only sold the vehicles through wholesale auctions.). See also U.C.C. § 9-311 cmt. 4.

338 See Trimarchi v. Together Dev. Corp., 255 B.R. 606 (Bankr. D. Mass. 1988).

339 See 15 U.S.C. § 1060.

however, file an "assignment" with the Commissioner of Patents and Trademarks,[340] as well as an Article 9 Financing Statement.

(xxxvii) ***Trusts*:** Filing. U.C.C. § 9-310(a).

(xxxviii) ***Visual Currency*:** These forms of currency are not deposit accounts because they are not provided by banks as defined under Article 9. See General Intangibles[341] supra.

PRACTICE TIP: Make sure there are no spendthrift provisions prohibiting a lien. Notify the trustee and obtain an acknowledgement of notification of the lien.

(C) Perfection By Filing[342]

(i) *UCC-1 Form and Authority to File*

Article 9 provides a form UCC-1 financing statement.[343] "Financing Statement" is defined as "an initial financing statement and any filed record relating to the initial

340 The "conditional assignment" becomes effective only upon default and exercise of its rights by the secured party. The secured party could also take a full assignment with a license back to the debtor, but this is more problematic. Under trademark law the owner must control the "nature and quality" of the trademark. Accordingly, a "naked assignment" or "assignment in gross" can vitiate a trademark. Thus, counsel must be careful in structuring the transaction, regardless of the form. Section 10 of the Lanham Act, 15 U.S.C. § 1060, requires assignments of federally registered trademarks to be filed with the U.S. Patent and Trademark Office. If the trademark is registered, the documents should identify the certificate of registration. If the registration is pending, the documents should note that the application is pending and include the serial number, date of filing, name of secured party and the notarized signature of the debtor. If the trademark is pending and is subsequently granted, then the secured party does not need to amend the trademark. See also 37 C.F.R. §§ 3.11-16 and 3.25. One filing may reference multiple trademarks held by the debtor, but the filing will need to be amended as the debtor acquires new trademarks.

341 One court has held that Bitcoin, at least in an investment context, is a currency or money. See SEC v. Shavers, supra. If Bitcoin or another virtual currency were deemed to be money, perfection would require possession. See Chapter IV, (B), xxvii (Money), supra.

342 As noted supra, the law of the state of the debtor's location governs perfection, the effect of perfection or non-perfection and priority of a security interest perfected by filing. U.C.C. § 9-301(1). The local jurisdiction where the collateral is located, however, governs perfection of a fixture filing in goods and a security interest in timber to be cut and the effect of perfection or non-perfection and priority of non-possessory liens in negotiable documents, goods, instruments, money or tangible chattel paper. U.C.C. § 9-301(3) (A), (B) and (C).

343 Every state that accepts paper UCC filings must accept the form. U.C.C. § 9-521(a). Certified copies of financing statements should be admissible in evidence. Fed. R. Evid.§ § 902 and 1005.

financing statement."[344] The financing statement does not need to be signed or authenticated by the debtor or secured party. It only needs to be filed by a person "entitled" to file it.[345] A filing subsequently authorized or ratified will relate back to the original filing.[346]

- Authority to file UCC-1. Because the UCC-1 no longer needs to be executed by the debtor an issue arises as to when a secured party is entitled to file a UCC-1. By executing or "authenticating" a security agreement, the debtor has authorized the filing of a UCC-1.[347] When the secured transaction is assigned to or assumed by a "new debtor," the new debtor is deemed to have authorized the filing of a UCC-1.[348] Similarly, when a person or entity acquires collateral subject to a security interest it is deemed to have authorized the filing of a UCC-1 against it.[349]

- Any amendment that adds collateral or adds a debtor must also be authorized by the debtor.[350] Any other amendment, however, need only be authorized by the secured party of record.[351] These amendments include continuation statements, assignments, amendments adding or deleting a secured party and termination statements.[352]

PRACTICE TIP: Because Article 9 does not prohibit pre-filing, many practitioners file the UCC-1 before the transaction closing to avoid any issues of timeliness, such as those that arise in the case of a PMSI lien. U.C.C. § 9-502(d). However, because under the 1999 revisions to Article 9 the debtor no longer executes the UCC-1, the UCC-1 is not "authorized" before authentication of the security agreement, unless the secured party obtains written authorization to pre-file. It is only then that the secured party has

344 See U.C.C. § 9-102(a)(39).

345 See U.C.C. § 9-509.

346 See U.C.C. § 9-502 cmt. 3. For ratification, see U.C.C. §9-322, cmt. 4. See also In Re The Adoni Group, 530 B.R. 592 (Bankr. S.D.N.Y. 2015).

347 See U.C.C. § 9-509(b). This authorization to file a financing statement also extends to filing against proceeds, even if the security agreement does not expressly cover the proceeds. U.C.C. § 9-509(b)(2). The authorization may also be oral or electronic. Post filing ratification may be acceptable. See U.C.C. § 9-502 cmt. 3. The holder of an agricultural lien may file without a written authorization because the lien arises as a matter of law. U.C.C. § 9-509(a)(2).

348 See U.C.C. § 9-509(b).

349 See U.C.C. § 9-509(c).

350 See U.C.C. § 9-509(a).

351 See U.C.C. § 9-511.

352 See U.C.C. § 9-509(d)(1).

authority to file the UCC-1. Because many secured parties do not obtain authorization to pre-file there is often a "gap" period. This "gap" period is problematic since Official Comment 3 to U.C.C. § 9-502 suggests that non-Article 9 law, including the law of ratification should govern whether the secured party had authority to pre-file. Since the law of ratification generally provides that ratification should not impair the rights of intervening third parties, and Article 9 generally provides that the first to file wins, regardless of authorization to file, there is a clear conflict. Official Comment 4 to U.C.C. § 9-322 under the 2010 Amendments prefers the first to file rule on the grounds that the notice value of the filing is independent of the authorization or ratification of the filing.

PRACTICE TIP: The secured party should obtain authorization to file a financing statement in the loan application documents, before the security agreement is even executed. The secured party should always also be sure to tender the exact filing fee required.

If a filing exceeds the authority of the person who filed it, the financing statement will only be effective to the extent it was authorized.[353] A secured party that files a financing statement without authority is liable for a statutory penalty of $500 plus actual damages.[354]

(ii) ***Necessary Information and Discretion of Filing Officer***

Generally, the secured party must include the names and addresses of the debtor and the secured party and a description of the collateral in the financing statement.[355] However, under Revised Article 9, the filing officer must reject the financing statement if it does not have the following: the secured party's address, an indication whether the debtor is an individual or organization, the type of organization and the jurisdiction of the organization.[356] Under the 2010 Amendments, a filing officer will no longer be permitted to reject a financing statement due to a failure to identify the type of organization or the jurisdiction of the organization. If the financing statement includes all the necessary information, the filing officer must accept it. If the financing statement does not include all the necessary information, the filing officer must reject it.[357] The filing officer has no discretion.

353 See U.C.C. § 9-510(a).

354 See U.C.C. § 9-625(b) and (e)(3).

355 See U.C.C. § 9-502. Additional real estate information is required in the case of a fixture filing or a filing against "as extracted collateral" or timber. See Additional Information Required For Fixture Filings and As Extracted Collateral Filings, infra.

356 See U.C.C. §§ 9-516(b)(4) and (5), 9-520(a).

357 See U.C.C. § 9-520(a).

The filing officer may only reject an initial filing for one of the following reasons:

(a) Record not communicated by a method or medium of communication authorized by the filing officer;
(b) An amount equal to or greater than the applicable filing fee is not tendered;
(c) The record does not provide a name for the debtor;
(d) The debtor identified as an individual but it is unclear how to index the first and last names (e.g., Elton John or John Elton);
(e) In the case of a fixture filing, the record does not provide a sufficient description of the real property;
(f) Failure to provide a mailing address for the debtor;
(g) Failure to provide a name and mailing address for the secured party;
(h) Failure to indicate whether the debtor is an individual or an organization;
(i) If the debtor is an organization failure to provide:
- A type of organization for the debtor;
- A jurisdiction or organization for the debtor; or
- An organizational identification number for the debtor or to indicate that the debtor has none; this is the number assigned by the corporations division of the state of incorporation and is found on the articles of incorporation. Some states, i.e., New York, do not assign a number so the "none" box would be checked) *and*

(j) In the case of an assignment filed under § 9-514(a), the record does not provide a name and mailing address for the assignee.

Note: Under the 2010 Amendments a filing officer will no longer be permitted to reject a financing statement for the reasons set forth in (i) above and these fields will be removed from the statutorily approved from of UCC-1.

A filing officer may reject an amendment only for one of the following reasons:

(a) Record not communicated by a method or medium of communication authorized by the filing office;
(b) An amount equal to or greater than the applicable filing fee is not tendered;
(c) The record does not identify the initial financing statement as required by § 9-512 or § 9-518, as applicable, or
(d) The record identifies an initial financing statement whose effectiveness has lapsed under § 9-515;

(e) The record provides a name identified as an individual which was not previously provided in the financing statement to which the record relates and the record does not identify the debtor's last name;

(f) The record does not provide a sufficient description of the real property to which is relates;

(g) In the case of an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record;

(h) In the case of an amendment that provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not:

- Provide a mailing address for the debtor;
- Indicate whether the debtor is an individual or an organization; or
- If the financing statement indicates that the debtor is an organization, failure to provide:
  - A type of organization for the debtor;
  - A jurisdiction of organization for the debtor; or
  - An organizational identification number for the debtor or indicate that the debtor has none; this is the number assigned by the corporations division of the state of incorporation and is found on the articles of incorporation. (Some states, i.e., New York, do not assign a number so the "none" box would be checked).

(i) In the case of an amendment filed under § 9-514(b), the record does not provide a name and mailing address for the assignee; and

(j) In the case of a continuation statement, the record is not filed within the six-month period prescribed by § 9-515(d).

As noted above, pursuant to § 9-502(a) the necessary information for a financing statement to be effective is as follows: the name of the secured party, (or its representative) the name of the debtor and a description of the collateral,[358] but pursuant to § 9-516(b) the filing officer must reject the financing statement if it does not also have the following: the secured party's address (or its representative's), the debtor's address, an indication of whether the debtor is an individual or an organization, the type of organization and the jurisdiction of the organization, except that, again, under the 2010 Amendments the filing office may no longer reject a financing statement due to a failure to include the type of organization or the jurisdiction of organization.[359]

358 See U.C.C. §§ 9-502, 9-503, 9-504.

359 See U.C.C. § 9-516(b)(4) and (5).

A filing statement that includes all the required information to be effective under § 9-502(a) (and (b) for fixtures) and § 9-516(b), but that is rejected by the filing officer is still effective against a bankruptcy trustee, but not against a purchaser who gives value in reasonable reliance upon the absence of the record from the files.[360] If a financing statement has all the information required by § 9-502(a) (and (b) for fixtures) but either omits or misstates information required by § 9-516(b), but is accepted by the filing officer, the financing statement is effective,[361] except that if the information required by § 9-516(b)(5) (address and corporate information of debtor) is incorrect or incomplete, a creditor (or buyer) that relies on the defective information and gives value will have priority.[362]

In the case of multiple debtors, the filing officer must make a separate determination with respect to each debtor.[363] Multiple secured parties may list only one as agent for the group.

The filing officer must advise the party submitting a financing statement of rejection within two business days and give the reason for the rejection.[364]

If a filing officer incorrectly indexes a filing, the secured party will still prevail over a subsequent lender that did not see the filing due to the error.[365] Note that this is a different result from when the filing officer improperly rejects a filing because the secured party has no responsibility to see that its filing is properly indexed. Article 9 does not address a filing office's liability for its errors. This issue is generally determined by state laws regarding governmental immunity.

If the filing office accepts forms it must accept the financing statement forms included in Article 9 at U.C.C. § 9-521.

For each filing record maintained, the filing office must do the following[366]:

1. Record not communicated by a method or medium of communication authorized by the filing office;
2. Assign a unique number to the filed record;
3. Create a record that bears the number assigned to the filed record and the date and time of filing;

360 See U.C.C. § 9-516(d).

361 See U.C.C. § 9-516 cmt. 9; In Re Montague, 409 B.R 685 (Bankr. D. Vt. 2009), amended by 417 B.R. 214 (financing statement effective despite misstating debtor's address).

362 See U.C.C. §§ 9-338, 9-520(c).

363 See U.C.C. § 9-520(d).

364 See U.C.C. § 9-520(b).

365 See U.C.C. § 9-517. See also U.C.C. § 9-517 cmt. 2, which provides that "this section imposes the risk of filing-office error on those who search the files rather than on those who file."

366 See U.C.C. § 9-519(a)–(e).

4. Maintain the filed record for public inspection; and
5. Index the filed record as follows:

   a. Index according to the name of the debtor and index all filed records relating to the initial financing statement in a manner that associates with one another an initial financing statement and all filed records relating to the initial financing statement; and
   b. Index a record that provides a name of a debtor which was not previously provided in the financing statement to which the record relates also according to the name that was not previously provided.
   c. If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index it:
      - Under the names of the debtor and of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property described; and
      - To the extent that the law of the state provides for indexing of records of mortgages under the name of the mortgagee, under the name of the secured party as if the secured party were the mortgagee thereunder, or, if indexing is by description, as if the financing statement were a record of a mortgage of the real property described.
   d. If a financing statement is filed as a fixture filing or covers as extracted collateral or timber to be cut, the filing office shall index an assignment filed under § 9-514(a) or an amendment filed under § 9-514(b):

      - Under the name of the assignor as grantor; and
      - To the extent that the law of this State provides for indexing a record of assignment of a mortgage under the name of the assignee, under the name of the assignee.

6. After January 1, 2002, the assigned file number must include a check digit that is mathematically derived from or related to the other digits of the file number and aides the filing office in determining whether a number communicated as the file number includes a single-digit or transposition error.
7. Filing officers shall timely perform the foregoing in accordance with their office rules, but no later than two business days after the filing office receives the record in question.

Finally, the filing officer must retain all records for at least one year after the financing statement has lapsed, and amendments, continuations and termination statements are considered to be part of the financing statement.[367]

(iii) *Assignments of UCC's*

As noted in Chapter I (E) (ii), supra, secured transactions may generally be freely assigned.[368] Upon assignment of a security interest, a financing statement may be assigned, by filing an amendment to the financing statement that identifies, by its file number, the initial financing statement to which it relates; provides the name of the assignor; and provides the name and mailing address of the assignee.[369]

The financing statement is not required to be assigned of record, when the underlying security agreement is assigned.[370] An assignee may choose not to file an assignment as when the secured party and the assignee do not want the debtor to know about the assignment. This is common in equipment lease "private label" programs where the debtor/lessor does not wish to disclose to the account debtor/lessee that it has pledged or assigned the transaction. This can, however, be risky for the assignee for three reasons. First, there is no obligation on the part of the account debtor to make payments to the assignee until it is informed about the assignment.[371] Second, a UCC search will not reveal the assignee's interest and thus, the assignee must rely on the assignor to inform it about notices and other inquiries. Third, where the right to payment has been fully earned, the debtor and assignor may modify the contract until the account debtor received notification of the assignment.[372]

---

367 See U.C.C. § 9-522(a).

368 A secured party may not, however, transfer a security interest without also transferring the debt or indebtedness. The security interest follows the debt. Rentenbach Constructors, Inc. v. CM P'ship, 181 N.C. App. 268, 639 S.E.2d 16 (N.C. Ct. App. 2007).

369 See U.C.C. § 9-514(b).

370 See U.C.C. § 9-514 cmt. 2. Until the financing statement is assigned of record, however, the original secured party remains the "secured party", authorized to file amendments. The assignee of a titled vehicle also generally is not required to amend the title to reflect the assignee as secured party. In Re Johnson, 407 B.R. 364 (Bankr. E.D. Ark. 2009). But see In Re Clark Contracting Servs., Inc., 399 B.R. 789 (Bankr. W.D. Tex. 2008), rev'd, 438 B.R. 913 (W.D. Tex. 2010) (explaining prior ruling was overruled by subsequent legislation).

371 See U.C.C. § 9-406(a). Upon proper notice the debtor must pay the assignee, and if she does not, and she continues to pay the debtor, she does so at her peril. Id.

372 See U.C.C. § 9-405(a). Notably, if the right to payment, or a part thereof, has not yet been fully earned, the debtor and assignor may modify the contract even after the account debtor is notified of the assignment. Id. Thus, a secured party should always be very careful about buying any contract not fully performed.

(iv) *Duration of Financing Statements, Effect of Lapsed Statements, Continuation Statements and Amendments*

Generally, a financing statement is effective for five years after the date of filing.[373]

A financing statement filed against a manufactured home or in a public finance transaction is good for 30 years after the date of filing.[374] A financing statement against a transmitting utility is also good for 30 years.[375] (**Note**: under the 2010 Amendments only an initial financing statement may indicate the debtor is a transmitting utility, making the transmitting utility filing provision similar to that of public finance and manufactured home transactions. This will satisfy the administrators' concern that they must be careful to capture all amendments to make sure they are not treated as lapsed.)

A record of a mortgage filed as a fixture filing, against as extracted collateral or timber under U.C.C. § 9-502(c) is good until released or otherwise becomes ineffective under real property law.[376]

A continuation statement must be filed within six months of the time the existing filing is scheduled to lapse.[377] The six-month rule is an absolute.[378] A continuation filing filed outside the six-month window is ineffective.[379] The filing of a new financing statement before the lapse of a prior filing is not effective to continue the original filing.[380] Indeed, in such case a junior creditor will obtain priority over the creditor whose financing statement lapsed, even where the junior creditor was aware of the prior lien and understood itself to have a second position.

The continuation statement should be filed even if the debtor is in bankruptcy. The U.S. Bankruptcy Code was amended to specifically provide that maintaining or continuing the perfection of a lien, and thus, filing of a continuation statement (to original

373 See U.C.C. § 9-515(a). Puerto Rico has a ten-year duration for financing statements. In Re Supplies & Servs., Inc., 461 B.R. 699 (B.A.P. 1st Cir. 2011). Wyoming also has ten year durations for financing statements filed after July 1, 2013. Wyo. Stat. § 34. 1-9-515(a). New York has a special duration provision for its non-uniform amendment regarding cooperatives. Under New York law a financing statement filed against a cooperative must include a cooperative addendum, in which case the financing statement's duration is fifty years. N.Y. U.C.C. Law § 9-515(h).

374 See U.C.C. § 9-515(b).

375 See U.C.C. § 9-515(f).

376 See U.C.C. §§ 9-515(g), 9-502(c).

377 See U.C.C. § 9-515(d).

378 See Barnes & Tucker Co. v. Westinghouse Elec. Corp., 216 Ga. App. 715, 455 S.E.2d 409 (Ga. Ct. App. 2004) (issue of attorney liability for failing to advise client of five year renewal need).

379 U.C.C. § 9-510(c).

380 See In Re Hilyard Drilling Co., Inc. 840 F.2d 596 (8th Cir. 1988).

collateral or proceeds)[381] does not violate the automatic stay.[382] Notably, based upon this amendment to the U.S. Bankruptcy Code Article 9 was also amended, in Revised Article 9, to delete the tolling provision of old § 9-403. This old section had provided that a financing statement would not lapse during a debtor's bankruptcy, but would be tolled until sixty days following the termination of the bankruptcy proceeding. A debtor's bankruptcy filing no longer tolls a financing statement.[383] Bankruptcy law, however, may still save a secured party who allows a financing statement to lapse during the debtor's bankruptcy. Some Bankruptcy Courts have held that the rights of secured parties are determined at the moment of the filing of the petition, and thus, a lapse thereafter is of no consequence to that secured party's position as a perfected secured creditor.[384] As one significant authority notes, however, while trustees should not trump a secured creditor whose financing statement lapses during the bankruptcy proceedings, other secured creditors or purchasers should obtain an enhanced position.[385] Secured parties should also not rely upon this potential bankruptcy law safety net because they will no longer be protected if the bankruptcy proceeding is dismissed. Moreover, where the secured party's perfection at the time of the debtor's bankruptcy filing is based upon a temporary "automatic" perfection, without filing, even the bankruptcy law safety net will not save the secured party.[386] Only a permanent "automatic" perfection, without filing, such as that on identifiable cash proceeds will come within the purview of the possible bankruptcy law safety net.[387]

The secured party may also file continuation statements after a debtor has been granted discharge, if the lien has not been extinguished.[388]

381 See U.C.C. § 9-509(b)(2).

382 See 11 U.S.C. 362(b)(3); U.C.C. § 546(b).

383 See U.C.C. § 9-515 cmt. 4.

384 See In Re Wilkinson, 2012 WL 1192780 (Bankr. N.D.N.Y. Apr. 10, 2012); In Re Miller Bros. Lumber Co., 2012 WL 1601316 (Bankr. N.C. May 8, 2012), rev'd, 2013 WL 5755052 (M.D.N.C. Oct. 23, 2013).

385 Barkley Clark & Barbara Clark, *Post Bankruptcy Lapse Perfection Doesn't Allow Trustee To Avoid Security Interest,* CLARKS' SECURED TRANSACTIONS MONTHLY, Jan. 2014, at 3-5 (citing the last sentence of U.C.C. § 9-515(c) and discussing In Re Miller Bros. Lumber Co., Inc., supra); see also, *Does Bankruptcy Excuse Filing of a Continuation Statement?,* CLARKS' SECURED TRANSACTIONS MONTHLY, Sept. 2012, 1-3; In Re Highland Construction Management Services, LP, 497 B.R. 829 (Bankr. E. D. Va. 2013).

386 See In Re Schwinn Cycling & Fitness, Inc., 313 B.R. 473, 477 (D. Col. 2004) (citing In Re Reliance Equities, Inc. 966 F.2d 1338 (10th Cir. 1992)).

387 Id.

388 See In Re Botson, 531 B.R. 719, 729 (Bankr. N.D. Ohio 2015).

The secured party should also file continuation statements when in litigation in a non-bankruptcy forum.[389]

If a financing statement lapses, a new one must be filed to reinstate perfection. The new filing must meet all the usual requirements, but the secured party still does not need the debtor's signature because the secured party is authorized to file as many statements as needed.[390]

Even without a future advance clause, a secured party is perfected on a future loan with the collateral of a pre-existing loan when the secured party obtains a new security agreement again granting a lien in that collateral. If the original financing statement did not expire, the secured party need not file a new one.[391] A future advance may even be secured by original collateral under an earlier security agreement where the initial loan was paid in full and there was a gap before the future advance.[392]

Finally, amendments that are not continuation statements do not prolong the effectiveness of the underlying UCC-1.[393] Amendments that add a debtor or collateral are effective only from the date of the amendment.[394]

(v) *Correction Statements*

Correction statements may be filed by a debtor where it believes a filing has been made against it by an unauthorized party.[395] Correction statements are informational only and have no legal effect.[396] Indeed, correction statements are generally viewed as being worthless.[397] Thus, if a secured party inadvertently terminates a UCC-1, thereafter filing a correction statement only will not reinstate the UCC-1 filing.[398]

---

389 Thermal Supply, Inc. v. Big Sky Beef, LLC, 195 P.3d 1227 (Mont. 2008). But see Avant Petroleum, Inc. v. Banque Paribas, 853 F.2d 140 (2d Cir. 1988).

390 See In Re Aliquippa Mach. Co., 343 B.R. 145, 59 U.C.C. Rep. Serv. 2d 773 (Bankr. W.D. Penn. 2006); In Re Cain, 356 B.R. 787 (B.A.P. 10th Cir. Jan. 19, 2007).

391 See U.C.C. § 9-323.

392 See Commercial Capital Bank v. House, 2012 WL 220214 (W.D. La. Jan. 24, 2012); In Re Howard, 312 B.R. 840 (Bankr. W.D. Ky. 2004); State Bank of Young Am. v. Vidmar Iron Works, Inc., 292 N.W.2d 244 (Minn. 1980).

393 See U.C.C. § 9-515(b).

394 See U.C.C. § 9-512(c) and (d).

395 See U.C.C. § 9-518.

396 See U.C.C. § 9-518(c).

397 See In Re Hickory Printing Group, Inc., 479 B.R. 388 (Bankr. W.D.N.C. 2012).

398 Id.

Under the 2010 Amendments, "corrective statements" are re-titled "information statements." Additionally, while under the old code only debtors could file corrective statements, under the 2010 Amendments, corrective statements may be filed by the debtor or the secured party about an alleged unauthorized amendment or other filing. The secured party is not, however, required to file a corrective/information statement even if it knows about the unauthorized filing.[399]

(vi) *Secured Party's Obligation to Terminate Financing Statements*

With consumer goods, the secured party must terminate the financing statement within thirty days after there is no current obligation and no commitment to give value in the future. The thirty days is reduced to twenty days when the secured party receives an authenticated request from the debtor.[400]

In the case of non-consumer goods, even where there is no current obligation and no commitment to give value, there is no obligation on behalf of the secured party to terminate a financing statement unless and until the secured party receives an authenticated demand. Upon receipt of a demand, the secured party has twenty days to file a termination statement or send one to the debtor.[401] If the secured party is not the secured party of record, the secured party must cause the secured party of record to comply with the debtor's request.[402]

Of course the secured party must also comply with this timetable to terminate a financing statement when the debtor did not authorize the filing of the initial financing statement.[403]

In the case of a secured party with control of a deposit account, electronic chattel paper, investment property or a letter of credit, when there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations or otherwise give value, the secured party must release control within ten days of receipt of an authenticated request.[404] When the secured party has notified account debtors of

399 See U.C.C. § 9-518(a) and (b).

400 See U.C.C. § 9-513(c)(1).

401 See U.C.C. § 9-513(c).

402 Accounts or chattel paper that have been sold are excepted from this requirement unless the account debtor or other person obligated has discharged the obligation. U.C.C. § 9-513(c)(1) and (2). Consignments are also excepted from the obligation except where the consigned goods are not in the debtor's possession. U.C.C. §§ 9-513(c)(1) and (3).

403 See U.C.C. § 9-513(a)(2) and (c)(4).

404 See U.C.C. § 9-208(b).

its security interest, it must send an authenticated record releasing the account debtors within ten days of receipt of an authenticated request.[405]

If the secured party fails to timely comply with these obligations it is liable to the debtor (or any guarantor or assignee) as it would be for filing an unauthorized financing statement for $500 plus actual damages, including the debtor's inability to obtain financing or the increased cost of financing.[406] Of course, the debtor may also then file the termination.[407]

The secured party with a lien on a title should check the title statute for similar obligations. Title statutes may not distinguish between consumer and non-consumer goods and may require the secured party to release the lien on the title without any authenticated request.[408]

(vii) *Termination Statements*

One may only file a termination statement if it is authorized by the secured party[409], and a filed termination statement is only effective to the extent it was authorized.[410] Thus, if the filing of the termination was authorized, upon its proper filing the original financing statement to which it relates, is terminated, and ceases to be of any effect.[411]

405 See U.C.C. § 9-209(b).

406 See U.C.C. § 9-625(b)–(c) and 9-625(e)(1), (2), (4).

407 See U.C.C. § 9-509(d)(2).

408 See N.J.S.A. 39:10-10.

409 See U.C.C. § 9-509(d).

410 See U.C.C. § 9-510(a). AEG Liquidations Trust v. Toobro NY LLC, 2011 WL 2535035 (N.Y. Sup. Ct. Jun. 24, 2011) (unauthorized termination statement)

411 See U.C.C. § 9-513(d).

A mistakenly filed termination statement, if filed by the secured party, is likely to be upheld.[412] The secured party is even very limited in its ability to argue that a mistakenly filed termination statement is not effective if it was filed by the debtor and went beyond the debtor's authorization, if the secured party reviewed the termination statement before filing..[413]

Finally, while as noted in subsection (vi) above, a debtor may file a termination statement where a secured party improperly fails to do so after request, a debtor's filing will not be effective unless same was properly filed.[414]

PRACTICE TIP: Secured parties should consider having the debtor file the termination statement, rather than doing so itself, under a letter clearly limiting the authorization to a particular loan.

(viii) *Providing the Required Information*

A financing statement must include the identity of the secured party and the debtor, and a description of the collateral.[415] Whether a description in a financing statement is adequate is a question of fact.[416] Several significant issues arise in completing a UCC-1:

412 See In Re Residential Capital, LLC, 480 B.R. 529 (Bankr. S.D.N.Y. 2013) (termination statement filed by collateral agent effective although collateral agent erred, because collateral agent was agent of secured party); Roswell Capital Partners LLC v. Alt. Constr. Techs., 2010 WL 3452378 (S.D.N.Y. Sept. 1, 2010) (secured party's termination of UCC was irreversible); Lange v. Mutual of Omaha Bank (In Re Negus-Sons, Inc.), 2011 WL 2470478 (Bankr. D. Neb. June 20, 2011) (bank mistakenly authorized another bank to terminate UCC-1); In Re Kitchin Equip. Co., Inc., 960 F.2d 1242 (4th Cir. 1992) (secured creditor inadvertently checked the "termination" box instead of the "partial release" box); In Re Pac. Trencher & Equip., Inc., 27 B.R. 167 (B.A.P. 9th Cir. 1983), aff'd, 735 F.2d 362 (9th Cir. 1984). But see Monroe Bank & Trust v. Chie Contractors, Inc., 2013 WL 1629300 (Mich. Ct. App. April 16, 2013) (Filed termination statement held not to be effective where secured party had blanket asset lien and checked both the termination box and the box to delete collateral and listed one piece of equipment, because the two boxes checked were incongruous and thus the error was plainly evident and any interested party should have known they should inquire further).

413 Official Comm. Of Unsec. Creditors of Motors Liquidation Co. v. JP Morgan Chase Bank, N.A. (In Re Motors Liquidation Co.), 777 F3d 100 (2nd Cir. 2015); see also 85 U.C.C. Rep. 2d 592 (2d Cir. 2015); In Re Oak Rock Financial, LLC, 527 B.R. 105 (Bankr. E.D.N.Y. 2015); But see In Re A.F. Evans Co., Inc., 2009 WL 2821510 (Bankr. N.D. Cal. July 14, 2009) (bank authorized filing of a UCC-1 but not the second one).

414 See Int'l Home Prods., Inc. v. First Bank of Puerto Rico, Inc., 495 B.R. 152 (D. Puerto Rico 2013).

415 See U.C.C. § 9-502(a).

416 See Security Tire & Rubber Co. v. Hlaas, 441 S.W.2d 91, 246 Ark. 1113 (Ark. 1969).

1. How to identify the debtor and secured party in the financing statement;
2. How to identify the collateral in the financing statement;
3. Where to file the financing statement;
4. What additional information must be included in a fixture filing and where the filing is to be made.

(a) Identifying the Debtor and Secured Party

Errors in the secured party's name are governed by U.C.C. § 9-506(a), entitled "minor errors and omissions." Errors of this nature will generally not undermine the effectiveness of the financing statement.[417] The financing statement may name the actual secured party or its representative, but in New Jersey the financing statement must include the actual name, not a trade name, unless the trade name is registered in New Jersey.[418] If the named secured party is acting as a collateral agent or trustee, it may, but is not required to, disclose the capacity in which it is acting.[419]

Errors in identifying the debtor, however, are governed by U.C.C. § 9-506(b), entitled, "financing statement seriously misleading." Errors in the debtor's name, even minor errors, can be fatal to a financing statement.[420] In one case the UCC-1 identification of the debtor was only missing the "s" on "Tires" in the debtor's name and it was deemed invalid because it did not come up in a search.[421]

The standard by which a UCC-1 filing is judged to determine whether it is a valid filing despite a deviation from the legal name is as follows: whether the filing is "materially misleading." A safe harbor is provided in subsection (c) of 9-506 which provides that a filing is not materially misleading if it would be revealed under the search logic of the recorder's office despite the deviation from the precise legal name. The trade

417 See In Re McGee, 2010 WL 9463258 (Bankr. N.D. Ind. April 21, 2010).

418 N.J.S.A.12A: 9-502 (a) (2).

419 See U.C.C. § 9-503(d). If there is more than one secured party, but none is acting in a representative capacity, all of the secured parties may be listed using the addendum, Item 12.

420 See In Re Tyringham Holdings, Inc., 354 B.R. 363 (Bankr. E.D. Va. 2006) (UCC-2 filing without "Inc." deemed invalid). Fortunately, most states now use a search logic that treats "Inc.," "LLC," "the," punctuation and spacing as noise and filter same out, but the Virginia State Corporation Commission's search logic at issue in Tyringham did not, at least at the time of the decision. Leaving out the "h" in "technologies" was fatal to a filing. In Re PTM Techs., Inc., 452 B.R. 165 (Bankr. M.D.N.C. 2011).

421 See In Re Jim Ross Tires, Inc., 379 B.R. 670 (Bankr. S.D. Tex. 2007).

association of the filing organization has created a flexible search logic standard, but all offices may not follow same.

The model UCC-1 form allows for listing more than one debtor. If the secured party wishes to include more than two debtors, the secured party should use the addendum form, Item 11. So long as one of the debtors listed is the proper debtor's name, the filing should be deemed to be valid.[422]

- Registered Organizations. When the debtor is a registered organization, such as a corporation formed under the authority of a state or the United States, the debtor must be identified in the financing statement exactly as it is identified in the organization's formation documents such as its certificate of incorporation filed in the office of the secretary of state or other appropriate governmental body. This rule is strictly enforced; cases are legion finding a UCC-1 filing invalid for a seemingly insignificant error in the description of the debtor. For example, where the debtor's name was "C.W. Mining Company," a filing under "CW Mining Company" was held to be inadequate.[423]

The 2010 Amendments provide two clarifications. First, if the entity has more than one name appearing in the documents on file with the Secretary of State, it is the "public organic record" that governs the name. The public organic record is the publicly available document filed to form the organization. Thus, the "certificate of formation" will govern over a "certificate of good standing". If the public organic record includes the name multiple times, the reference that is specifically identified as stating the name of the debtor controls. Second, the definition of "registered organization" is modified in two respects. The 2010 Amendments clarify that to be a registered organization the entry must be formed solely under the law of a single state by the filing of a public record. This amendment makes clear that a registered organization is one that creates a "birth certificate" upon the act of a public filing. The change means that a statutory trust created under state law by filing will qualify as a registered organization. The 2010 Amendments also expand the definition of "registered organization" to include common law trusts formed for a business or

422 See Textron Fin. Corp. v. New Horizon Home Sales, Inc., 2011 WL 901844 (N.D. W.Va. Mar. 15, 2011).

423 See In Re C.W. Mining Co., 488 B.R. 715 (Bankr D. Utah 2013). The IRS, however, is not bound by this rule; In Re Spearing Tool & Mfg. Co., 412 F.3d 653 (6th Cir. 2005).

commercial purpose and that are required by state law to file with the state an organic record, such as the trust agreement. Common law trusts that are not formed for business or commercial purposes or that are not required to file a public record will not qualify. Limited liability partnerships ("LLP"), which may have been formed as a general partnership without any public filing, and then which file, not to create the entity, but rather to obtain limited liability, will also not qualify as "registered organizations" for purposes of Article 9.

- Non-Registered Organizations. When the debtor is a non-registered organization, but it has a name, such as a partnership, that name must be used. If the non-registered entity does not have a name, the filing must provide the names of the partners, members, associates or other persons making up the organization.[424] The secured party must, however, make sure the non-registered organization is indeed a legal entity. For example, a secured party which assumed its debtor was a joint venture lost its lien when a bankruptcy court held that there was no joint venture or general partnership entity separate from the individuals, and thus, the secured party's filing was defective.[425] Whether a partnership exists generally turns on the parties' intentions which is very fact sensitive.

- Trusts. Identifying the Debtor when the debtor is a trust turns, initially, on whether the trust is a registered organization.[426] (See discussion of 2010 Amendments above addressing statutory and common law trusts.) If the collateral is held in a trust that is a registered organization, the name to be provided on the financing statement, as under old Article 9, must be the name of the trust itself as reflected on the trust's "current public organic records" as defined in section 9-102(a)(68), and no indication or trust status is required.[427] If the trust is not a registered organization, the next step is to determine

424 See U.C.C. § 9-503(a)(4). With non-registered organizations the secured party must be sure it knows with what type of entity it is dealing. For example, just because the debtor represents that it is a "joint venture" does not mean that it is a partnership or separate legal entity. See In Re Webb, 742 F.3d 824 (8th Cir. 2014).

425 In Re Webb, 742 F.3d. 824 (8th Cir. 2014). The secured party should look to see that all formalities have been met, including but not limited to transfer of title and separate tax returns.

426 See U.C.C. § 9-503(a)(3).

427 See U.C.C. § 9-503(a)(1).

whether the trust's "organic" records specify a name.[428] Organic record is not defined. If the organic record specifies a name, said name must be used and the 2010 Amendments require that when the collateral is held in a trust that is not a registered organization the filer must indicate in a separate part of the financing statement a statement that the collateral is held in trust.[429] The reference to "collateral held in trust" replaces the required reference under old Article 9 to the trust or the trustee. The reference to the debtor as a trust or trustee was confusing because under the common law in most states the debtor would be the trustee. If the trust is not a registered organization and the organic documents do not specify a name, the debtor's name should be the name of the settlor or testator as provided in the trust's organic record, but if the settlor is a registered organization the name used then must be the settlor's name on its current public organic record.[430] If the name of the settlor or testator is provided as the debtor's name, the filer must provide in a separate part of the financing statement sufficient information to distinguish the trust from other trusts created by the same settlor or testator. The date of the trust instrument will frequently suffice for this purpose.

- Individual/Proprietorship. When the debtor is an individual or a sole proprietorship the debtor must be identified by his/her legal name. No nicknames. No "d/b/a" names. This provision has generated a great deal of confusion and consternation. Is the legal name the name on a driver's license? A passport? Or only on a birth certificate? The 2010 Amendments include two options to address this issue.

    - Under Alternative A, if the debtor has a current and valid driver's license the financing statement must use the exact name as it appears on the driver's license. Alternative A has

428 See U.C.C. § 9-503(a)(3).

429 See U.C.C. § 9-503 (a)(3)(A)(i) and (B)(i). The new UCC-1 form provides a check box to indicate a trust. The trust indication may also be provided in an addendum form (UCC-1Ad) if the jurisdiction accepts same, or finally as exhibit to the UCC-1.

430 See U.C.C. § 9-503(a)(3) and (b).

been referred to as the "only if" approach because the filing will be valid "only if" it is consistent with the driver's license. If the debtor does not have a current and valid driver's license, then the debtor's name on the financing statement must be either (1) the individual name of the debtor, as under current Article 9, or (2) the debtor's surname and first personal name.

- Under Alternative B any of the following will be sufficient: (1) the debtor's name as shown on the debtor's driver's license; (2) the individual name of the debtor, as under current Article 9; or (3) the debtor's surname and first personal name. Alternative B has been called the "safe harbor" approach, "Under either Alternative A or Alternative B, if the debtor holds two driver's licenses issued by the state, the most recently issued driver's license is the one to which reference should be made to determine the debtor's name to be provided on the financing statement."

Most pundits favor Alternative A. One significant disadvantage of Alternative B is that it focuses upon perfection, but not priority. Filing under any of the three alternatives will suffice, and anyone searching the records will need to search all three alternatives to ensure priority. Notably, California rejected both Alternatives A and B and created its own non-uniform provision. Under California's version of § 9-503, the name of an individual debtor must be either (1) the "individual" name of the debtor or (2) the surname and first personal name. As noted above, California also delayed the effective date of the 2010 Amendments to July 1, 2014.

PRACTICE TIP*: *The driver's license upon which a secured party relies must be issued by the state of the debtor's primary residence, and that must be the state in which the secured party files. A name on another state's driver's license would not qualify for the safe harbor, and as noted above, expired driver's licenses do not count. Indeed, if the license expires and the debtor's name is different than that on the license, a name change will have been triggered, and the filing must be amended. If the driver's license is suspended or revoked you must determine whether the driver's license is expired under state law. If the license is not expired the license will qualify. Use driver's license name, exactly even if contains a typo. If the driver's license name is so long it does not fit in the financing statement box, use the financing statement addendum form (9-521). If

in doubt, file against multiple names. The debtor may have a state issued identification card. These cards are acceptable, if issued by the same agency that issues driver's licenses and if they are issued in lieu of, and not in addition to, driver's licenses. If the debtor has multiple licenses issued by the state of primary residence, the most recent license is the one that controls. When in doubt, file against multiple names.

- Estate. A debtor may be an estate. The 2010 amendments refer to collateral that is being administered by a personal representative of a deceased debtor. In this case, the name of the deceased debtor on the financing statement will be sufficient as a "safe harbor" if the name provided is the name of the debtor on the court order appointing the personal representative. If the appointment order contains more than one name for the debtor, the first name of the debtor on the appointment order is sufficient.[431] The financing statement must also indicate that the collateral is being administered by a personal representative.[432] There is a check box for this indication in Item 5 of the new UCC-1 Form. This indication may also be provided in the miscellaneous field of the financing statement addendum (form UCC1-AD), if such form is accepted in the jurisdiction or as exhibit to the financing statement.

PRACTICE TIP: There is no penalty under Revised Article 9 for filing multiple financing statements. When in doubt, file under all possible names. Do not, however, include d/b/a's or alternate names in one filing. Instead, include the alternate name as an "additional" debtor in the relevant portion of the UCC-1. If there is more than one additional debtor, use the addendum form and complete Item 11. Alternatively, just file additional financing statements for each name, although there may be additional fees. U.C.C. § 9-525(c). Although not required, it is also advisable to run a search after your filing to make sure the filing comes up under the search logic of the recording office.[433]

431 See U.C.C. § 9-503(f). While other names in the list may not qualify under the subsection (f), safe harbor provision, they may still qualify as the name of the decedent under section 9-503(a)(2). U.C.C. § 9-503, cmt. 2.C.

432 See U.C.C. § 9-503(a)(2). Failure to comply with the "indication" requirement will render the filing defective.

433 The secured party is not required to run a search after filing. Textron Fin. Corp. v. New Horizon Home Sales, Inc., 2011 WL 901844 (N.D. W.Va. Mar. 15, 2011). Thus, the secured party will not lose its priority where the filing office mis-files the UCC-1. U.C.C. § 9-517.

(b) Identifying the Collateral in the Financing Statement

The collateral may be defined in the financing statement in one of two ways. First, the collateral may be defined as it would be in a security agreement under § 9-108, discussed more fully above.[434] Second, when the security interest is a general asset or blanket lien the collateral may be defined by using one of a two super generics: "all assets" or "all personal property."[435] Due to the "notice filing" nature of Article 9, a collateral description may suffice in a financing statement, although it would clearly be insufficient in a security agreement. For example, a description of "all inventory financed by CIT Group" in a financing statement was upheld even where the transaction was assigned to Wells Fargo and they did not amend the financing statement.[436] At least one court even upheld a collateral description where the secured party used the wrong Article 9 category in defining the collateral, where the court concluded the description, in its entirety, was a "reasonable identification."[437]

A financing statement that specifically identifies the collateral, and misidentifies it such as where the financing statement includes an incorrect serial or model number, is much more problematic[438]. In such a case, the secured party will probably need an all asset filing as well to overcome misidentifying collateral.[439]

A secured party that wishes to file an "all asset" financing statement against a "new debtor" or "transferee" should get a specific authorization in the security agreement or otherwise, as the rules deeming new debtors to have authorized a UCC-1 filing do not specifically authorize the filing of an "all asset" lien, but only on "the collateral described in the security agreement."[440]

In New Jersey, the collateral description in the financing statement must also include a statement to the effect that all the described collateral falls within the scope of Article 9 as enacted in New Jersey.[441]

---

434 See U.C.C. § 9-504(1).

435 See U.C.C. § 9-504(2).

436 See In Re D&L Equip., Inc., 457 B.R. 616, 75 U.C.C. Rep. Serv. 2d 525 (E.D. Mich. 2011).

437 See In Re Brown, 479 B.R. 112 (D. Kan. 2012) (secured party's collateral description identified LLC membership collateral as investment property instead of as general intangible).

438 See In Re Pickle Logging, Inc., 286 B.R. 181 (Bankr. M.D. Ga. 2002).

439 See Pro Growth Bank, Inc. v. Wells Fargo Bank, N.A., 558 F.3d 809 (8th Cir. 2009). But see Bishop v. Alliance Banking Co., 412 S.W.3d 217 (Ky. Ct. App. 2013) (mis-stated serial number not fatal to filing).

440 See U.C.C. § 9-509(b) and (c).

441 See N.J.S.A. 12A:9-502 (a) (3).

When the loan documents bar the debtor from granting junior liens on the collateral the secured party may want to include in the financing statement a paragraph specifically noting that the debtor has contractually agreed not to pledge, encumber or otherwise permit any other liens on same. The secured party may even wish to include language suggesting that the acceptance of a subordinate lien by any other secured party may constitute a tortious interference with the initial secured party's contractual rights. Notably, a contractual provision precluding the granting of junior liens does not stop such liens from taking effect.[442] Putting future secured lenders on notice of the contractual provision barring the granting of junior liens may, however, be helpful in giving rise to a tortious interference claim as such a claim generally requires inter alia, knowledge by the defendant of the contractual prohibition.[443]

PRACTICE TIP: An "all asset" or "all personal property" filing will cover all proceeds of the collateral, but a filing against specific collateral may not maximize the secured party's rights in proceeds unless the secured party includes the proper proceeds language in the financing statement. **See *Priority of Liens in Proceeds,* infra.**

(c) Additional Information Required for Fixture Filings and As Extracted Collateral Filings

Fixture filings and filings against "as-extracted collateral" or timber must include additional information: A fixture filing must indicate that it is a fixture filing and covers goods of this type, indicate it is to be filed in the real property records, provide a sufficient description of the real property such as would be required in a mortgage in the jurisdiction at issue (i.e., lot and block of the real property),[444] and give the landlord or other record owner's name if the debtor does not have an interest in the real property.[445] A mortgage may serve as a financing statement if it has all the required information,[446] but out of an abundance of caution many practitioners file a financing statement as well. The fixture filing is also filed in a different location from a non-fixture filing. It

442 See U.C.C. § 9-401(b).

443 See Lama Holding Co. v. Smith, 646 N.Y.S.2d 76 (1996).

444 A metes and bounds description is not required.

445 See U.C.C. § 9-502(b).

446 See U.C.C. § 9-502(b).

is generally filed in the county where the real property is located, as opposed to with a state agency.[447]

- Utility Exception. Utilities such as electric companies, sewer companies and railroad and subway systems often own fixtures in many different parcels of real property. Accordingly, Article 9 creates an exception for "transmitting utilities," which are defined as entities that (1) operate a railroad, subway, street railway, or trolley bus; (2) transmit communications electrically, electromagnetically, or by light; (3) transmit goods by pipeline or sewer; or (4) transmit or producing and transmitting electricity, steam, gas, or water.[448]

    - In the case of transmitting utilities a filing need only be made in a designated central office (usually the secretary of state) in each state in which the utility has fixtures.[449] Significantly, the financing statement is not required to describe the real estate.[450]

(d) Where to File the Financing Statement

UCC-1 filings, other than fixture filings and filings for timber to be cut, must be filed in the state of the debtor's "location."[451]

- Individual Debtors. For individuals, the debtor's location is the state of the individual's principal residence.[452]
- Registered Organization Debtors. The debtors' location for registered organizations is the state where the entity was formed and currently exists.[453] This is, like the discussion regarding identifying the debtors in subsection (a), supra, the so-called "birth certificate" rule.

447 See U.C.C. § 9-501(a)(1). Louisiana is the exception. See Chapter III, B (How to Perfect in Various Types of Collateral), xv (Fixtures), supra.

448 See U.C.C. § 9-102(a)(80).

449 See U.C.C. § 9-501(b).

450 See U.C.C. § 9-501(b). Filings for fixture filings and timber to be cut are also governed by local law. U.C.C. § 9-301(3).

451 See U.C.C. § 9-301(1).

452 See U.C.C. § 9-307(b)(1).

453 See U.C.C. § 9-307(d). This applies even if the debtor is suspended. U.C.C. § 9-307 cmt. 4. "However, certain of these events may result in, or be accompanied by, a transfer of collateral from the registered organization to another debtor." Id.

Note: As is also noted in subsection (a), supra, the 2010 Amendments include a new definition of "public organic record", which is the record filed to form the entity. As noted in subsection (a) supra, this is to be distinguished from an entity that is not created by the filing of the public record, but does so for another reason, such as a limited liability partnership. Under the 1997 Uniform Partnership Act a general partnership may have been created without any public filing, by the simple contractual association of the partners, but if the partnership wishes to become an LLP it must file a public record, to wit, a statement of qualification, to obtain limited liability. Significantly, the filing of the statement of qualification does not create a new entity, but merely provides for limited liability of the existing entity. Thus, the location for purposes of filing a UCC-1 is not the state of filing of the statement of qualification, but rather the location as determined for an unregistered organization as provided in the immediate section below. Finally, it should be noted that a limited partnership, unlike a limited liability partnership, is generally formed like a corporation and thus would have a public organic record or birth certificate to determine its location for purposes of Article 9.

Section 9-102(a)(70) defines a registered organization as an organization formed under the law of a "single" state. Thus, an entity formed under the laws of more than one state is not a registered organization, and 9-307(3) does not govern. Rather, 9-307(b)(2) and (3) govern. If the company has places of business in more than one state, 9-307(b)(2) doesn't apply, and 9-307(b)(3) governs, locating the debtor at its chief executive offices.

- Unregistered Organization Debtors. The debtors' location for organizations that are not formally created, such as some general partnerships, is the state where the organization has its place of business if it has only one place of business.[454] If the organization has more than one place of business, its location is the state where its chief executive office is located.[455]
- Foreign Debtors. Foreign debtors will generally be located in a foreign jurisdiction. If that jurisdiction does not provide for public notice of security interests, the foreign debtor is deemed to be located in the District of Columbia.[456]

454 See U.C.C. § 9-307(b)(2).

455 See U.C.C. § 9-307(b)(3).

456 See U.C.C. § 9-307(c). As noted above, for non-possessory security interests in negotiable documents, goods, instruments, money or tangible chattel paper, local law governs the effect of perfection or non-perfection and priority. Thus, for such non-possessory security interests, Article 9 may indicate the secured party should file the UCC-1 in the District of Columbia, but the local law of the foreign jurisdiction may govern the effect of perfection and priority. As a result, the secured party's filing in D.C. may not protect the secured party, depending upon local law. This problem is compounded where the collateral is scattered around the globe, such as with ocean liner containers.

- Other. The location of a federally chartered bank and a branch or agency of a bank not organized under federal or state law is as follows:

    1. In the state designated by federal law, if the law designates a state of location;

In the state that the registered organization, branch, or agency designates, if federal law authorizes the registered organization, branch, or agency to designate its State of location; or

In the District of Columbia, if neither paragraph (1) nor paragraph (2) applies.457

The 2010 Amendments clarify that if an organization registered under federal law (if permitted to make that determination by federal law), designates its main office as its location, it shall be located in the state of its main office for purposes of Article 9.

- Fixtures. For fixture filings, the financing statement must be filed in the county of the real estate to which the collateral is to be affixed, regardless of the debtor's state of incorporation or place of business or residence.[458] Because it is not always clear whether all the collateral is fixtures, it is generally advisable that the secured party file in the secretary of state's office as well. (But see utility exception above for "transmitting utilities," dispensing with the requirement of a filing in the county and with a description of the real estate.)
- Estates and Trusts. The location for the filing of the financing statement is the location of the debtor under the applicable general security agreement, pursuant to Section 9-307, not the location of the person or entity whose name is in the debtor name field of the financing statement.

PRACTICE TIP: There is no penalty under Article 9 for filing multiple financing statements. If there is any doubt about where to file, the secured party should file in all of the possible places, except perhaps in the few states that charge substantial filing fees or taxes, such as Florida and Tennessee.

457 See U.C.C. § 9-307(f)(1)–(3).

458 See U.C.C. § 9-501(a)(1)(B). Louisiana is the exception. See Chapter III, (B), xv (Fixtures), supra.

(D) Maintaining Perfection And Priority When Circumstances Change After Closing

One of the most complex areas of Article 9 is how to maintain lien perfection and priority where perfection is through filing and there are material changes after closing, such as when the debtor changes its name or location, transfers the collateral to a third party or merges with another entity. Generally, the steps necessary to protect the lien and its priority will depend on whether the lien pertains only to existing collateral or also applies to after-acquired collateral.

(i) ***Debtor Relocates the Collateral***

Because the UCC-1 filing location is determined based on the debtor's "location" and not the location of the collateral, no action is required when the debtor relocates the collateral, so long as the debtor's "location" for purposes of Article 9 remains the same. The exception, of course, is fixtures since filing in those cases must be in the county where the real property is located.

(ii) ***Debtor Changes Its Name***

(a) Existing Collateral: When the debtor merely changes its name, the secured party need not take any action to maintain its lien.[459] Article 9 generally imposes an obligation on a new secured party to inquire about prior names and to search them.

PRACTICE TIP: Although not required, the secured party should consider amending its UCC-1 to reflect the debtor's new name, perhaps by adding the debtor's new name as an additional debtor.

(b) After-Acquired Collateral: If the collateral is not limited to property in existence at the time of closing, but includes property that will come into existence subsequently, such as accounts, inventory or "equipment now owned or hereafter acquired," the secured party must file under the debtor's new name within four (4) months of the debtor's name change.[460]

459 See U.C.C. § 9-507(c)(1). For an excellent article on maintaining perfection post-closing, see, Robert Ihne, *How to Maintain Perfection and Priority When Changes Occur After Closing,* The Secured Lender, Vol. 60, NO. 3 (May/June 2004). See also, updated article to incorporate 2010 Amendments, *How to Maintain Perfection and Priority When Changes Occur After Closing – Revised Following the 2010 Amendments to Article 9,* www.cogencyglobal.com (September 21, 2013).

460 See U.C.C. § 9-507(c)(2).

(iii) *Debtor Changes its "Location" For Purposes of Article 9*

(a) **Existing Collateral**: The secured party must file a UCC-1 in the venue of the debtor's new "location" within four (4) months of the debtor's changing its location.[461] Failure to timely file leaves the security interest unperfected prospectively and retroactively.[462] The four months is reduced where the original filing will lapse earlier.[463] When a registered organization merges with another entity or converts to a registered entity in a different state, the secured party needs to determine whether the successor entity is legally considered to be the same organization or a new entity under the law of the state of merger or conversion. When the organization is legally considered to be the same entity after the merger or conversion, the secured party should be able to follow the same rules as when the debtor changes location. Where, however, the successor entity is deemed under law to be a new entity, the secured party must comply with the "new debtor" rules discussed below.

(b) **After-Acquired Collateral:** Prior to the 2010 Amendments, there was no grace period for after-acquired collateral. The 2010 Amendments extend the same four month grace period to after-acquired collateral. Thus, under the amendment, any new lender or buyer outside the ordinary course must make sure it inquires' about any change in "location" of the debtor within the last four months. If the secured party fails to timely file in the new state it loses priority to other secured parties or purchasers, but not to donees and lien creditors. Thus, the secured party still prevails over a trustee in bankruptcy. [464]

(iv) *Unauthorized Sale of Existing Collateral*

Any sale or other transfer by the debtor of the collateral, except in the ordinary course of debtor's business, is subject to the secured party's lien.[465] When the transferee is in the same "location" as the debtor for purposes of Article 9, the secured party need not take any action to retain its perfection and priority. If the transferee is located in a

461 See U.C.C. § 9-316(a)(2).
462 See U.C.C. § 9-316(b).
463 See U.C.C. § 9-316(a)(e).
464 See U.C.C. § 9-316.
465 See U.C.C. § 9-315(a)(1).

different jurisdiction from the debtor for purposes of Article 9, the secured party has one year to file in the new venue to preserve its perfection and priority.[466]

PRACTICE TIP: Even when not required, it is advisable to file against the transferee. No authorization from the buyer is required for the secured party to file the UCC-1. U.C.C. §§ 9-509(d) and 9-102(a)(28).

(v) *The "New Debtor": Mergers and Transfer and Assumption Agreements*

The new debtor generally comes into existence when the debtor does not retain its original identity under a merger or conversion to another state or when the debtor's obligations are assigned to and assumed by another entity, with the secured party's consent.

(a) Existing Collateral: With existing collateral the perfection and priority rules are the same as a sale outside the ordinary course of business as discussed above.

(b) After-Acquired Collateral: Effectively, the new debtor is granting the secured party a new security interest in after-acquired collateral.[467] Thus, if the new debtor is located in the same location as the original debtor, the secured party need not take any action unless the new debtor's name is sufficiently different from the original debtor that the secured party would not be deemed perfected under the original filing. If the new debtor's name is sufficiently different to require a new filing the secured party has four months to file against the new debtor, to be perfected against collateral acquired by the new debtor within the four month period.[468]Prior to the 2010 Amendments, there was no grace period. The secured party needed to file immediately. Under the 2010 Amendments a grace period of four months is created for after-acquired collateral, like the case of a debtor changing location, so that the result in an interstate merger will be the same as in an intrastate merger. If the secured party fails to timely file in the new

466 See U.C.C. § 9-316(a)(3). The secured party may be able to argue that its lien perfection continues, even after one year and even without filings in the new jurisdiction, as against the buyer but will not be able to make this argument as against the buyers' creditors and/or the buyer's buyer, absent actual knowledge of the secured party's lien. DZ Bank AG Deutsche Zentral-Genossenschaftsbank v. Connect Insurance Co., 2016 WL 6315744 (W.D. Wash. 2016). But see First Nat'l Bank of Picayone v. Pearl River, 971 So. 2d 302 (La. 2007).

467 See U.C.C. § 9-203(e).

468 See U.C.C. § 9-508 (a) and (b).

state it may still prevail over a bankruptcy trustee and lien creditor. See Note 2 to subsection (iii) above.

(E) Perfecting Through Possession

The law of the state of the location of the collateral generally governs the perfection, effect of perfection or non-perfection and priority of a security interest perfected by possession.[469] Perfection may be by possession for goods, instruments, negotiable documents, money,[470] or tangible chattel paper and certificated securities.[471] "Possession" is governed by Article 9 for all such collateral, except certificated securities, which are governed by U.C.C. § 8-301, although subsections (e), (f) and (g) of U.C.C. § 9-313 apply to a third party's possession of security certificates for the secured party's benefit.[472]

Taking physical possession of tangible or quasi-tangible collateral is generally easy to visualize. When the debtor gives up all possession and control, such as when he gives the collateral to a pawn broker, the secured party clearly has possession. Conversely, when the debtor retains possession or control, the secured party is probably not perfected.

Neither the debtor nor a person controlled by the debtor qualifies as an "agent" of the secured party.[473] Non-Article 9 principles of "agency" govern.[474] If the person is truly an agent of the secured party, the secured party need not rely on a third-party acknowledgement.[475] The fact that the "agent" may be the agent of both the secured party and the debtor does not automatically defeat the perfection. In such a case, however, the secured party should be sure to get an acknowledgement from the agent to assure perfection under U.C.C. § 9-313(c), at least in the cases of collateral other than certificated securities and goods covered by a document.[476] The agent may not, however, be so connected to the debtor that the debtor has effectively retained control.[477]

---

469 See U.C.C. § 9-301(2).

470 Possession of keys to safe deposit box holding gold coins upheld as to perfection. See In Re Rose, 2010 WL 1740635 (Bankr. D. Neb. Apr. 29, 2010).

471 If the secured party perfects through possession, it must take possession of all originals See In Re Funding Sys. Asset Mgmt. Corp., 111 B.R. 500 (Bankr. W.D. Pa. 1990).

472 See U.C.C. § 9-313(a) cmt. 6.

473 See U.C.C. § 9-313 cmt. 3.

474 See U.C.C. § 9-313 cmt. 2.

475 See U.C.C. § 9-313 cmt. 3.

476 See U.C.C. § 9-313(a), 9-313 cmt. 3.

477 Id.

A Temporary Restraining Order ("TRO") granting the right to possession does not constitute possession.[478]

With collateral other than certificated securities and goods covered by a document, a secured party can also perfect through "constructive possession."[479] In such cases, the bailee must authenticate a record acknowledging it holds the collateral for the benefit of the secured party.[480] The bailee is not required to provide such a record[481] and has no obligation to the secured party unless it agrees to assume that obligation in an authenticated document or other applicable law imposes such an obligation. (Compare U.C.C. § 9-312(d) governing goods covered by nonnegotiable documents under which the secured party does not need to obtain an authenticated record from the bailee acknowledging that it holds the collateral for the secured party, but only needs to notify the bailee.)[482]

An exception to this rule addresses the concerns of mortgage warehouse lenders. Under this exception, the secured party is deemed to have retained possession of collateral if it instructs the bailee before or at the time of delivery that it must hold the collateral for the benefit of the secured party or that it must redeliver it to the secured party, such as upon default.[483] The secured party is considered to have possession even if the delivery of the collateral under U.C.C. § 9-313(h) violates the debtor's rights.[484] The secured party delivers the collateral under § 9-313(h) at its own risk, however, as the third party to whom the collateral is delivered does not owe the secured party a duty and is not required to confirm that the collateral has been delivered to any other person unless otherwise required by law.[485]

(F) Perfecting Through Control

Revised Article 9 adopted the concept of control from Article 8 of the U.C.C. As provided in U.C.C. § 9-314(a), "[a] security interest in investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper may be perfected by control of the collateral."[486]

478 See In Re Commercial Money Ctr., Inc., 350 B.R. 465, 481 (B.A.P. 9th Cir. 2007).

479 See U.C.C. § 9-313(c).

480 See U.C.C. § 9-313(c).

481 See U.C.C. § 9-313(f).

482 See U.C.C. § 9-313(g)(2).

483 See U.C.C. § 9-313(h).

484 See U.C.C. § 9-313(i).

485 See U.C.C. § 9-313(i).

486 See, e.g., U.C.C. §§ 9-104, 9-105, 9-106, or 9-107.

Note: The debtor may still have access to the account without the secured party being deemed to have given up control,[487] except with respect to money taken out of the account.[488]

(i) *Control of a Deposit Account*

A secured party has control of a deposit account if:

- **(a)** The secured party is the bank with which the deposit account is maintained;[489]
- **(b)** The debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the account without further consent by the debtor;[490] or
- **(c)** The secured party becomes the bank's customer with respect to the deposit account.[491]

Note: The 2010 Amendments include a revision to Official Comment 3, incorporating an example of control by an agent, as follows:

Example: Defendant maintains a deposit account with Bank A. To secure a loan from Banks X, Y and Z, defendant creates a security interest in the deposit account in favor of Bank A, as agent for Banks X, Y and Z. Because Bank A is a "secured party" as defined in Section 9-102, the security interest is perfected by control under [Section 9-104(a)(1)].

(ii) Control of Electronic Chattel Paper

A secured party has control of electronic chattel paper when there is a special electronic identification of the secured party on the electronic copy. More specifically, the

487 See U.C.C. § 9-104(b).

488 See U.C.C. § 9-332(b).

489 If the bank's loan is assigned the assignee is not perfected. See In Re Versus Inv. Mgmt., 344 B.R. 536 (Bankr. N.D. Ohio 2006).

490 The "control agreement" should identify all deposit accounts. See Full Throttle Films, Inc. v. Nat'l Mobile Television, Inc., 180 Cal. App. 4th 1438 (Cal. Ct. App. 2010) (levying judgment creditor prevailed where control agreement identified two accounts but did not identify the third account upon which the judgment creditor levied). But see In Re S.E. Stud & Components, Inc., 2015 WL 7750209 (Bankr. M.D. Ala. Dec. 1, 2015) (control agreement upheld even though it included the wrong deposit account number where same provided by debtor.)

491 See U.C.C. § 9-104.

record or records comprising the chattel paper must be created, stored, and assigned in such a manner that:

(a) A single authoritative copy of the record or records exists which is unique, identifiable and except as otherwise provided in paragraphs (4), (5), and (6), unalterable;
(b) The authoritative copy identifies the secured party as the assignee of the record or records;
(c) The authoritative copy is communicated to and maintained by the secured party or its designated custodian;
(d) Copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party;
(e) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and
(f) Any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.492

Note: The 2010 Amendments modify the requirements for control of electronic chattel paper to conform with Article 7 for electronic documents of title and the Uniform Electronic Transactions Act for Transferable Records.

(iii) Control of A Certificated Security, Uncertificated Security, or Security Entitlement

As provided in § 8-106, a secured party has control of investment property when the securities intermediary, with the consent of the debtor, agrees with the secured party that it will follow directions from the secured party without further consent of the debtor, as provided in § 8-106.[493]

(a) Certificated Securities Directly Held By The Debtor

1. Bearer form. Delivery of certificate to secured party.[494]
2. Registered in debtor's name. The debtor should endorse the certificate to the secured party or in blank or provide a stock power endorsed to the

492 See U.C.C. § 9-105.
493 See U.C.C. § 9-106(a).
494 See U.C.C. §§ 8-106(a), 8-301(a) and 9-106(a).

secured party or in blank attached to the certificate.[495] A blank endorsement is preferred for foreclosures.

3. Certificates in favor of the secured party in blank. Provide stock power endorsed to secured party or in blank attached to the certificate and deliver to secured party.[496]
4. The secured party can take possession of a certificated security without endorsement in favor of the secured party or in blank.[497] This procedure is effective for perfection, without the endorsement. It does not give the secured party control. Another creditor who obtains control will have a superior interest. The secured party would, however, be superior to a secured party that only filed a financing statement.[498]
5. Security is registered to debtor. Registry control by the securities in the name of the secured party.[499]

Note: If the security is in bearer form possession alone will be control. If the security is in registered form the secured party must obtain an endorsement or registration of a transfer to the secured party on the issuer's books, in order to obtain control. The secured party is, however, perfected for Article 9 purposes without the endorsement or registration, and with possession alone. U.C.C. § 9-203(b). But the secured party will be vulnerable to adverse interests under Article 8. U.C.C. § 8-510. Like other investment property, control trumps filing. U.C.C. § 9-328(1). If two liens are to be in place, the pledgee must acknowledge that it holds possession for the benefit of the second lien holder. U.C.C. § 9-313(c)(1).

Note: If a partnership or LLC elects to become "investment property" under Article 8, the secured party should perfect as provided above.

495 See U.C.C. § 8-106(b)(1).

496 See U.C.C. §§ 8-106(b)(1), 8-301(a) and 9-106(a). Endorsement in blank is preferred as it is easier to transfer upon foreclosure.

497 See U.C.C. § 9-313(a).

498 See U.C.C. § 9-328(5).

499 See U.C.C. §§ 8-106(b)(2) and 9-106(a).

(b) Uncertificated Securites Directly Held By The Debtor

- When a secured party enters into a contract with the issuer, a "control contract," the issuer agrees to comply with the instructions of the secured party;[500] or
- The secured party registered as the registered owner.[501]

(c) Financial Assets Indirectly Held By The Debtor Through Intermediary

- The security, or other financial assets, credited to a security account for the debtor:
  - **(i)** A contract with an intermediary-a control contract- The intermediary agrees to follow the instructions of the secured party without consent of the debtor.[502]
  - **(ii)** The secured party becomes the entitlement holder of the account.[503]
  - **(iii)** Must obtain a subordination agreement from the intermediary, otherwise the intermediary also has control.

(d) Commodity Contracts Of The Debtor In Commodity Accounts

- Secured party should obtain a control contract from an intermediary.[504]
- The secured party should get a subordination because the intermediary has control too[505] and will have priority.[506]
- "Control" is not lost because the debtor can trade or deal with assets.[507]
- The security extends to all securities' entitlements in the account[508] because control extends to the account itself.[509]

500 See U.C.C. §§ 8-106(c)(2) and 9-106(a).
501 See U.C.C. §§ 8-106(c)(1), 8-301(b)(1) and 9-106(a).
502 See U.C.C. §§ 8-106(d)(2) and 9-106(a).
503 See U.C.C. §§ 8-106(d)(1) and 9-106(a).
504 See U.C.C. § 9-106(b)(2).
505 See U.C.C. § 9-106(b)(1).
506 See U.C.C. § 9-328(4).
507 See U.C.C. § 9-106(F).
508 See U.C.C. § 9-203(h).
509 See U.C.C. § 9-106(c).

e) Federal Book-Entity Securities[510]

- The book entity securities are financial assets credited to the securities account.[511] Thus, a secured party may perfect by filing or control. For control, see financial assets held indirectly by debtor above.
- Treasury regulations only apply to book-entity form, not certificated. If they are certificated, they can be perfected, as with a certificated security, if directly held by the debtor or by the intermediary.

Note: The secured party retains control in repledge transactions.[512]
A secured party has control of a commodity contract if:

(1) The secured party is the commodity intermediary with which the commodity contract is carried; or
(2) The commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.[513]

Note: If a secured party has control over all the security interests or commodity contracts in a particular account the security party has control over the account.[514]

(f) Control of Letter of Credit

A secured party has control of a letter of credit right to the extent of any right to payment or performance by the issuer or any nominated person if the

510 31 C.F.R. §§ 306.115-117. Federal book-entity securities consist of treasury bonds, notes, certificate of indebtedness and bills. Generally, the U.C.C. applies to issues of attachment, perfection and priority. Usually these securities would be bought through a bank, broker or securities custodian, which has its own account with the federal reserve bank and buys and credits debtor's account. Under the U.C.C., the bank, broker or securities custodian is a securities intermediary and the account is a securities account.

511 See U.C.C. §§ 8-102(a)(9), (14). Id. § 8-501.

512 See U.C.C. § 9-314(c).

513 See U.C.C. § 9-106(b)(1), (2).

514 See U.C.C. § 9-106(c).

issuer or nominated person has consented to an assignment of proceeds of the letter of credit under § 5-114(c) or other applicable law or practice provides.[515]

(iv) *Secret Liens Often Trump Even Perfection By Control in Deposit Accounts, Investment Accounts and Letters of Credit*

Even a control agreement does not give a secured party a lien senior to all other creditors in deposit accounts and investment accounts, unless the secured party takes additional steps. A depository bank that also has a lending relationship with the depositor whereby the bank is granted a lien in accounts will automatically have a superior lien and right of setoff or recoupment in a bank account with the depository bank.[516] The superior lien and right of setoff or recoupment are superior to the secured party's rights even when the depository bank enters into a control agreement, unless the bank subordinates the lien and waives the right of setoff and recoupment or the secured party becomes a direct customer of the depository bank.[517] Securities and commodities intermediaries have similar secret super-priority liens in investment accounts.[518] Transferee beneficiaries and nominated persons also have super-priority in letters of credit.[519] A secured party needs to be aware of the super- priority, "secret liens," of depository banks, securities and commodities brokers and intermediaries, and transferee beneficiaries and nominated persons.

515 See U.C.C. § 9-107.

516 See U.C.C. §§ 9-327(3) and 9-340(a).

517 See U.C.C. § 9-340(c).

518 See U.C.C. § 9-328(3) and (4). See Priority of Liens, infra.

519 See U.C.C. § 9-329(1).

IV

PRIORITY OF LIENS

A security interest in collateral continues in the collateral despite a sale or other disposition unless the disposition was authorized by the secured party free and clear of security interest,[520] such as an inventory sale in the ordinary course. Indeed, a non-ordinary course buyer buys subject to a lien of which it is unaware, and of which it is aware even if that lien is unperfected.[521]

When competing liens are not perfected, priority is established in the order of attachment. When one lien is perfected and one is not, the perfected lien prevails.[522] Generally, when competing liens are perfected, when neither lien is a PMSI and the liens are perfected through the same means, the first creditor to file or perfect prevails: first in time, first in line.[523] If the competing liens are perfected through different means, with the exception of goods, the first in time rule may not apply since possession often trumps filing, and control often trumps all other modes of perfection, regardless of order of the perfection. In other words, when none of the competing liens are perfected, the priority will be determined by the order of attachment.[524] When one of the competing liens is perfected and the others are not, the perfected lien will prevail.[525] When all of the competing liens are perfected through filing, the first to file will have

520 See U.C.C. § 9-315(a)(1).
521 See U.C.C. § 9-317(b).
522 See U.C.C. § 9-322(a).
523 Id.
524 See U.C.C. § 9-322(a)(3).
525 See U.C.C. § 9-322(a)(2).

priority; when all of the competing liens are perfected through possession, the first to take possession will have priority; and when all of the competing liens are perfected through control, the first to take control will have priority. But when the liens are perfected through different means, except in the case of goods, a subsequent possession may trump a prior filing and a subsequent control generally trumps all. Priority issues become even more complicated when one secured party claims a lien in original collateral and another claims a lien in proceeds.[526]

(A) First in Time, First in Line

When all perfection is effected through filing, priority will go to the first to file even if the debtor did not have rights in the collateral at the time of the first filing and the security interest could not have "attached" at the time. That is to say, once there is attachment, the first to file will have priority over all subsequent filings even though the security agreements all attached at the same time, namely when the debtor acquired an interest in the collateral.[527] Additionally, the first to file wins even if he knew about the prior lien that had not yet been perfected,[528] and even if one of his financing statements lapses but an older filing was still valid.[529]

PRACTICE TIP: Revised Article 9 permits pre-filing. Whenever possible, a secured party should file as early as possible. Indeed, the secured party should file the financing statement upon execution of the security agreement by the debtor, even when there has not yet been attachment.

(B) Second in Time, First in Line: Possession and Control

When the competing secured parties are both perfected, but they are perfected through different means, the analysis becomes more complicated. When the first

526 See U.C.C. § 9-322. See Priority of Liens in Proceeds, infra.

527 See U.C.C. § 9-322(a)(1). See also U.C.C. § 9-322 cmt. 5, ex. 4.

528 See U.C.C. § 9-322. See also U.C.C. § 9-322 cmt. 4, ex. 1. In extraordinary circumstances, however, a court may subordinate a prior perfected secured creditor, such as where such creditor violated a special relationship such as a fiduciary duty. Feresi v. The Livery, LLC, 232 Cal. App. 4th 419, 182 Cal. Rptr. 3d 169 (Cal. Ct. App. 2014).

529 Commercial Capital Bank v. House, 2012 WL 220214 (W.D. La. Jan. 24, 2012) (where prior loan had a future advance clause and the prior loans financing statement had not lapsed, the secured creditor prevailed over subsequently filed secured creditor even though financing statement for open loan had lapsed).

secured party perfects by filing and the second files by control in a deposit account, investment property or letter of credit, the second secured party wins, even if it knew about the first perfected security interest.[530] In this situation, second in time is first in line. When the second secured party perfects through possession of chattel paper or an instrument, it will also often trump a prior perfected secured party that perfected through filing only, unless the second party knows that its lien violates the rights of the first secured party.[531] Here again, second in time, can be first in line. The same result occurs when the first lien's perfection was automatic, such as in the sale of a promissory note and the second party takes possession.[532]

Even when a secured party has control, it is not assured of priority over all others. Even a secured party with control in deposit accounts, investment accounts and letters of credit is subordinate to secret liens of depository banks, securities and commodities intermediaries and beneficiaries and nominated person, respectively.[533] A secured party with a control agreement is also subordinate to the claims of a collecting bank under Article 4.[534]

Finally, Article 9 also generally defers to the rights of "holders in due course" under Article 3, "holders" under Article 7 and "protected purchasers" under Article 8 "to the extent" those Articles provide superpriority.[535] These provisions often give rise to scenarios where again "second in time" may be "first in line," this time in the cases of negotiable instruments, documents and securities, respectively, and even accounts, such as when the junior lien holder (or second in time) qualifies as a holder in due course when it receives the proceeds of the collateral by check.[536]

---

530 See U.C.C. §§ 9-327(1), 9-328(1), 9-329(1).

531 See U.C.C. §§ 9-330(d), 9-331; See (C), (i) Chattel Paper and Instruments subsection, infra. A unique issue occurs when the debtor executes more than one original and different secured creditors take possession of the different "originals." In such a case, 9-322(a)(1)(i) provides that priority will be determined based upon the first to file or perfect. Since both secured creditors likely did not file, priority will be based upon which secured party took possession first. See HSBC Bank USA, N.A. v. Perez, 165 So. 3d 696 (Fla. Dist. Ct. App. 2015).

532 Id.

533 See Perfecting Through Control, supra.

534 See U.C.C. §§ 9-203(c), 4-210.

535 See U.C.C. § 9-331.

536 See U.C.C. § 9-331(a); Dallas Bank & Trust Co. v. Frigiking, Inc., 692 S.W.2d 163 (Tex. App. 1985); Thorp Commercial Corp. v. Northgate Indus., Inc., 490 F. Supp. 197 (D. Minn. 1980), rev'd on other grounds, 654 F.2d 1245 (8th Cir. 1981); Allstate Fin. Corp. v. Finacorp., Inc., 934 F.2d 55 (4th Cir. 1991); Utility Contractors Fin. Servs., Inc. v. Amsouth Bank N.A. (In Re Joe Morgan, Inc.), 985 F.2d 1554 (11th Cir. 1993). But see In Re Jersey Tractor Trailer Training Inc., 580 F.3d 147 (3d Cir. 2009) (factor not HIDC as failed to meet good faith test).

(C) Filing versus Possession

Generally, with goods, the first to file wins, except in the case of a PMSI, discussed more fully below. If a subsequent secured party fails to order a UCC search or orders a search but overlooks a prior UCC-1 filing, the subsequent secured party makes the loan at its peril. In the interest of maximizing the secondary market for commercial paper, however, Article 9 applies different standards in certain situations. As a result, in dealing with certain types of collateral, a secured party needs to be wary of not only prior liens or sales, but also subsequent sales or liens that may actually be able to leap-frog earlier liens.

Liens in chattel paper and instruments may be perfected through filing or possession, or, in the case of electronic chattel paper, filing or control. A lien follows its proceeds, which in the case of inventory is often chattel paper and instruments that arise in connection with the sale of inventory. Thus, in the cases of chattel paper and instruments it is possible to have competing liens perfected through different means: one through filing and another through possession or control.

(i) *Chattel Paper and Instruments*

U.C.C. § 9-330 addresses competing lien claims in chattel paper, providing as follows:

(a) Purchaser's priority: security interest claim merely as proceeds – A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

- In good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 9-105 (electronic chattel paper); and
- The chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

Note: "Subsection (a) revises the rule in former section 9-308(b) to eliminate reference to what the purchaser knows."[537]

(b) Purchaser's priority: other security interests – A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject

537 See U.C.C. § 9-330 cmt. 5.

to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 9-105 (electronic chattel paper) in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.[538]

Note: "Subsection (b) eliminates the requirement that the purchaser take without knowledge that the 'specific paper' is subject to the security interest and substitutes for it the requirement that the purchaser take 'without knowledge that the purchaser violates the rights of the secured party.' ... Note, however, that 'knowledge means actual knowledge.' In contrast to a junior secured party in accounts ... a purchaser of chattel paper under this section is not required as a matter of good faith to make a search in order to determine the existence of prior security interests."[539]

(c) Chattel paper purchaser's priority in proceeds – Except as otherwise provided in § 9-327,[540] a purchaser having priority in chattel paper under subsection (a) or (b) also has priority in proceeds of the chattel paper to the extent that:

- The purchaser would have priority under the usual rules governing priority in proceeds;[541] or
- The proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods, even if the purchaser's security interest in the proceeds is unperfected.[542] This scenario exists where goods were sold or leased pursuant to chattel paper in which the secured party has a lien, and the goods are subsequently returned.

(d) Instrument purchaser's priority – Except as otherwise provided in Section 9-331(a), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.[543]

538 For a discussion of priority where there is more than one original, see Footnote 531 supra.

539 See U.C.C. § 9-330 cmt. 6 (internal citations omitted).

540 Priority of Security Interest in Deposit Account.

541 See U.C.C. § 9-330(c)(1).

542 See U.C.C. § 9-330(c)(2) cmt. 10; U.C.C. § 9-330.

543 For a discussion of priority where there is more than one original, see Footnote 531 supra.

(e) **Holder of purchase-money-security interest gives new value** – For purposes of subsections (a) and (b), the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of inventory.

(f) **Indication of assignment gives knowledge** – For purposes of subsections (b) and (d), if the chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party.

Thus, under § 9-330 a secured party that perfects through filing only exposes itself to a priority claim by one who subsequently takes possession of the chattel paper or instrument. Indeed, the secured party is subordinated to the rights of a purchaser for new value that takes possession in the ordinary course of its business even though it knows that the specific paper or instrument is subject to the security interest, unless it also knows that the purchase violates the secured party's rights. Note also that in the case of instruments, the purchaser need not even give "new" value or make the purchase in the ordinary course of its business.

PRACTICE TIP: Two important concepts must be noted in connection with promissory notes and mortgages. First, the mortgage follows the note.[544] Second, because the mortgage follows the note, Article 9 trumps real estate mortgage law regarding priority of liens.[545] Thus, where a note and mortgage were double pledged, and creditor A perfected under Article 9 by taking possession of the original note and filing a UCC-1 and creditor B perfected by filing a notice of the assignment of the mortgage in the real property records, creditor A had priority in the note and mortgage.[546] Accordingly, when taking a lien in a note and mortgage, perfection under Article 9 is paramount, even though the mortgage clearly is an interest in real property.

(ii) ***Documents***

(a) **Negotiable Instruments** – A holder of a negotiable document will generally prevail over anyone with a claim to the goods that are the subject of the negotiable document. A secured party with a lien on

544 See In Re HW Partners, LLC, 81 U.C.C. Rep. Serv. 2d 704 (Bankr. E.D. Wash. 2013).

545 Id.

546 Id.

the goods before the issuance of the negotiable document will prevail, however, if the secured party has not,

- Delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this Article (Section 7-403) or with power of disposition under this Act (Sections 2-403 and 9-307) or other statute or rule of law; nor
- Acquiesced in the procurement by the bailor or his nominee of any document of title.[547]

(D) Control versus other Forms of Perfection

(i) ***Investment Property*** – If a security interest in investment property is perfected only by filing, it will lose priority to an interest perfected by control even if control is obtained subsequent to the time of filing.[548] If competing security interests in investment property are both perfected by control, they rank in the order of obtaining control.[549] There are several exceptions to these general principles. A security interest perfected by control in favor of the debtor's securities intermediary has priority over a security interest perfected either by filing or control.[550] When the investment property consists of a security certificate without any necessary endorsements, the security interest that is perfected by control is superior to another interest perfected by filing.[551] When investment property collateral is transferred to a person protected under Article 8's claim cutoff rules, the transferee remains protected under those rules.[552]

547 See U.C.C. § 7-503(1).
548 See U.C.C. § 9-328(1).
549 See U.C.C. § 9-328(2).
550 See U.C.C. § 9-328(3).
551 See U.C.C. § 9-325(5).
552 See U.C.C. § 9-331(b).

(ii) ***Securities Entitlements Carried in Securities Accounts*** – When there are conflicting security interests in investment property consisting of securities entitlements carried in securities accounts, the interests rank according to the time that:

(a) The secured party has the security entitlement transferred to its own securities account;
(b) A securities intermediary agrees to comply with the secured party's orders regarding the disposition of the investment property; or
(c) If the secured party exercises control through another person, the priority is based on the time on which priority would be based if the other person were the secured party.[553]

(iii) ***Deposit Accounts*** – A security interest in a deposit account perfected by control is superior to an interest in the account created by some other method, such as a claim that the deposit account is proceeds of other collateral.[554] Competing security interests each perfected by control rank in priority according to the time of obtaining control.[555] However, an interest perfected in favor of the debtor's depository bank, and the bank's rights of set-off and recoupment, will prevail over the interest of any other secured party in the account (including one with "control"), unless the other party becomes the depositary bank's customer on the account (for example, by having its name substituted for that of the debtor on the account).[556] The courts are split on whether a levying creditor has priority where the depository bank has not exercised its right of set off or

553 See U.C.C. § 9-328 cmt. 4.

554 See U.C.C. § 9-327(1); Platte Valley Bank v. Tetra Fin. Group, LLC, 2011 WL 335595 (D. Neb. Jan. 31, 2011), aff'd, 682 F.3d 1078 (8th Cir. 2012).

555 See U.C.C. § 9-327(2).

556 See U.C.C. §§ 9-327(3), 9-327(4), 9-340.

lien rights, and the debtor still has the freedom to draw on the account.[557] A violation of the control agreement by the depository bank should be actionable.[558]

PRACTICE TIP: Absent collusion to violate the rights of the secured party, a transferee of funds from the account takes free of the security interest in the account.[559] A bankruptcy trustee does not, however, qualify as a protected transferee because he is the legal successor to the debtor and gives no consideration for the turnover. Thus, a bank that held an automatically perfected security interest in a deposit account did not forfeit its priority when it released the funds from the account upon a bankruptcy filing of the account debtor.[560] Nevertheless, upon a bankruptcy filing, rather than release the funds to the trustee and then assert a lien without control, a bank should place an administrative freeze on the account and file a motion in the bankruptcy court to lift the stay.[561]

(iv) ***Letter of Credit Rights*** – A security interest in a letter-of-credit right that is a supporting obligation is perfected automatically.[562] A security interest perfected by control of a letter of credit is superior to a security interest in a letter-of-credit right perfected automatically as a supporting

---

557 See Fifth Third Bank v. People's Nat'l Bank, 929 N.E.2d 210 (Ind. Ct. App. 2010) (bank's lien superior); Myers v. Christensen, 776 N.W.2d 201 (Neb. 2009) (bank's lien superior). But see Stierwalt v. Associated Third Party Administrators, 2016 WL 2996936 (N.D. Cal. May 25, 2016) (levying creditor protected under Article 9's transferee rule even when the court has not yet released the funds); Am. Home Assurance Co. v. Weaver Aggregate Transp., Inc., 89 F. Supp. 3d 1294 (M.D. Fla. 2015) (perfected security interest also may not defeat garnishment); Frierson v. United Farm Agency, Inc., 868 F.2d 302 (8th Cir. 1989) (bank must use its rights of set off or lien or lose same, but it cannot deny levying creditor and forgo its own rights and allow debtor continued use of funds); One CW, LLC v. Cartridge World N. Am., LLC, 661 F. Supp. 2d 931 (N.D. Ill. 2009). But even in the line of cases allowing the garnishment despite the perfected security interest, it is unclear whether the secured creditor is deemed to have waived its ability to enforce its security interest or whether the garnishment is subject to the security interest. Davis v. F.W. Financial Services, Inc. 317 P.3d 916 (Or. Ct. App. 2013); see also David I. Cisau and Christopher J. Schreiber, Use It Or Lose It? Priority Dispute Over Deposit Accounts, 35 Amer. Bankr. J. 12 (Feb. 2016).

558 But see City Nat'l Bank of Fl. v. Morgan Stanley DW, Inc., 2006 WL 1582074 (S.D.N.Y. June 9, 2006) (depository bank not liable since control agreement called for notice of objection by secured party within 10 days, which notice was not provided).

559 See U.C.C. § 9-332(b).

560 See In Re Cumberland Molded Prods., LLC, 431 B.R. 718 (B.A.P. 6th Cir. 2010).

561 Id. at 725 (citing Citizens Bank of Md. v. Strumpf, 516 U.S. 16 (1995)).

562 There is automatic attachment and perfection. U.C.C. §§ 9-203(f) and 9-308(d).

obligation.[563] If there are competing interests each perfected by control, priority is by the time of obtaining control.[564] A security interest in a letter-of-credit right is subordinate to the rights of a transferee beneficiary or nominated person under U.C.C. § 5-114.[565] If the secured party also becomes the transferee beneficiary, it will also have the right to draw and receive the proceeds directly from the issuer, but it is unclear whether Article 9 or Article 5 governs their rights and responsibilities.[566] To become the transferee beneficiary, the secured party generally needs to complete the issuer's transfer forms and pay a fee. The letter of credit is then reissued in favor of the secured party.[567] A letter of credit is generally not transferrable unless it so provides or the issuer consents.[568] Unless the letter of credit provides otherwise, a letter of credit subject to the UCP may not be transferred a second time except back to the original transferor.[569] Finally, the secured party will need to meet all the conditions to draw on the letter of credit, including providing all required documents.[570]

(v) ***Commodities Contracts Carried in a Commodities Account*** - Where there are conflicting security interests in investment property consisting of commodities contracts carried with a commodities intermediary, the interests rank according to the time that control is obtained pursuant to U.C.C. § 9-106(b)(2) (Control of Investment Property).[571]

Control over a commodity contract exists when the commodity customer, the secured party and the commodity intermediary have agreed

563 See U.C.C. § 9-329(1). Thus, control is clearly preferred. The secured party should obtain the consent of the issuer to an assignment of the proceeds. U.C.C. § 5-114(c). This process gives the secured party control of the letter of credit and rights against the issuer. U.C.C. § 9-107. The secured party has the right to get money directly from the issuer without the debtor's consent. U.C.C. § 9-409(b).

564 See U.C.C. § 9-329(2).

565 See U.C.C. § 9-329(1).

566 See U.C.C. § 9-329 cmt. 3.

567 See U.C.C. § 5-112.

568 Id.

569 See U.C.P. art. 38(d).

570 See U.C.C. § 5-110.

571 See U.C.C. § 9-328(2)(C).

that the intermediary will act on the direction of the secured party without obtaining the additional consent of the commodity customer.[572]

(E) Transfer of Money

Article 9 seeks to ensure the free flow of funds. Accordingly, a transferee of money takes free of any security interest absent collusion with the debtor to violate a secured party's rights.[573]

(F) Transferee of Funds From a Deposit Account

Like a transferee of money, a transferee of funds from a deposit account takes free of any security interest absent collusion. This rule is based upon a strong public policy concern for finality in the bank payment system. Thus, this rule is strictly enforced.[574] Indeed, the collusion exception is extremely limited, even compared to the standard applied to an aider or abettor under tort law.[575] This perfection is limited to the transfer of funds from the account and does not apply to the transfer of the account.[576] A very limited exception may exist for a transfer to an escrow account.[577]

572 See U.C.C. § 9-106(b)(2).

573 See U.C.C. § 9-332(a). Note: that a bankruptcy trustee cannot qualify as a protected transferee because he is the legal successor to the debtor and he gives no consideration for the turnover of the debtor's assets. See In Re Cumberland Molded Prods., Inc. 431 B.R. 718 (B.A.P. 6th Cir. 2010). But levying creditor may qualify as a protected transferee. Orix Fin. Servs., Inc. v. Kovacs, 167 Cal. App. 4th 242, 66 U.C.C. Rep. Serv. 2d 1063 (2008).

574 Stierwalt v. Associated Third Party Administrators, supra (levying creditor trumped prior perfected secured creditors even where court had not yet released the funds); Legal Asset Funding, LLC v. Cousins, 2013 WL 2248084 (N.J. Super. Ct. App. Div. May 23, 2013); Rabbia v. Rocha, 34 A.3d 1220 (N.H. 2011) (transferee trumps secured creditor); Keybank Nat'l Ass'n v. Ruiz Food Prods., Inc., 2005 WL 2218441 (D. Idaho Sept. 9, 2005) (unsecured creditor transferee trumps secured creditor); Orix Fin. Servs., Inc. v. Kovacs, 167 Cal. App. 4th 242, 66 U.C.C. Rep. Serv. 2d 1063 (2008) (garnishing creditor who received funds); Gen. Elec. Capital Corp. v. Union Planters Bank, NA, 409 F. 3d 1049 (8th Cir. 2005) (junior creditor trumps senior creditor). But see Zimmerling v. Affinity Fed. Corp., 86 Mass. App. Ct. 136 (Mass. App. Ct. August 18, 2014) (The take free rule does not apply to a transfer from a deposit account to an escrow account). See also Deposit Accounts, supra.

575 Legal Asset Funding, supra.

576 See U.C.C. § 9-332(b) cmt. 2.

577 See Zimmerling v. Affinity Federal Corp., 86 Mass. App. Ct. 136 (Mass. App. Ct. 2014).

(G) Purchase Money Security Interests (PMSI)

PMSI'S can only exist in "goods" and "software" (to the extent the software is acquired in a transaction in which the secured party also obtains a PMSI in the goods and the software is to be used[578]). PMSIs are the most frequently encountered exception to the first-filed rule. Because Article 9 specifically authorizes after-acquired collateral liens, without the PMSI exception a debtor would never again be able to acquire personal property without the newly acquired property being subject to a first priority claim of the after-acquired lien. Thus, the debtor would never again be able to finance the purchase of new personal property unless it obtained the new financing from the existing secured party or if it were lucky enough to obtain the consent of the secured party to subordinate its lien.

The U.C.C. seeks to encourage new financings. The law does not want the debtor to be at the mercy of the existing secured party, especially when the existing secured party (with the after-acquired lien) is not harmed in any way by the new financing: the debtor could not have acquired the new collateral without the new financing from the new lender. Thus, the U.C.C. provides that when the new secured party finances the debtor's acquisition of goods (i.e., the new secured party's funds enable the debtor to purchase the new collateral), the new secured party may obtain a first and senior lien in the specific goods collateral without the existing secured party's consent or a subordination, so long as the PMSI is perfected when the debtor receives possession of the collateral or within 20 days thereafter.[579]

A PMSI obligation in goods is defined as follows:

> ...an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.[580]

Thus, a PMSI obligation has three requirements: (1) the secured party gives value; (2) the funds are intended to enable the debtor to acquire certain goods; and (3) the funds are actually used to acquire the goods. In short, for a PMSI to arise the value

578 See U.C.C. §§ 9-324(f), 9-103(c).

579 See U.C.C. § 9-103(b).

580 See U.C.C. § 9-103(a)(2).

provided by the secured party must be used to purchase all or part of the collateral.[581] Accordingly, a secured creditor seeking to obtain "PMSI" status should tender directly to the vendor.

Under the "close nexus" or "closely allied" doctrine (hereinafter the "close nexus doctrine") a secured creditor may obtain PMSI status when the loan proceeds are not tendered directly to the vendor and where the loan proceeds may be tendered prior to, or even after, the vendor has been paid. The application of the close nexus doctrine, however, is very fact sensitive and is applied on a case by case basis by the courts. Therefore, a secured creditor seeking to rely upon the close nexus doctrine will by definition be assuming an element of risk and a heavier and more costly burden of proof if the PMSI status is contested, even though an official comment to Article 9 (Official Comment 3), to Section 9-103 of the U.C.C.), one of the drafters Article 9 (Professor Gilmore), a leading authority on Article 9 (B. Clark) and case law support the proposition that a secured creditor may obtain PMSI status where there is a "close nexus" between the funding and the acquisition.[582]

The "value" may not be antecedent debt, but need not be limited to only the direct purchase price of the acquired collateral. Most courts have found a PMSI to include the negative equity of a trade in.[583] A PMSI also clearly includes taxes, freight and other expenses incurred to acquire the collateral, even enforcement expenses and attorney's fees.[584]

The requirement for the proper and timely perfection of a PMSI in goods other than inventory, livestock and fixtures, states "if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days thereafter.[585]

---

581 See U.C.C. § 9-103(f). Notably, in non-consumer transactions, PMSI and non-PMSI obligations may be secured simultaneously on PMSI collateral without disturbing the PMSI character. See also The Transformation Doctrine section, infra.

582 See In the Matter of Faith Ann Peaslee, 13 N.Y. 3d 75 (N.Y. 2009); First Nat'l Bank In Munday v. Lubbock Feeders, L.P., 183 S.W.3d 875 (Tex. Ct. App. 2006); Gen. Elec. Capital Commercial Automotive Fin. v. Spartan Motors, 246 A.D.2d 41, 50, 675 N.Y.S.2d 626 (N.Y. App. Div. 2d Dep't. 1998); The DeKalb Bank v. Robert A. Purdy, 205 III. App.3d 62 (Ill. Ct. App. 1990); In Re T&R Flagg Logging, Inc. 399 B.R. 334 (Bankr. Court, D. Maine, 2009); In Re Donald Ray Winchester, 2007 WL 420391 (Bankr. Court, N.D. Iowa, 2007); In Re the Matter of Stephen E. Seye, Sheryal L. Seye, 2006 WL 7067890 (Bankr. Court, S.D. Iowa, 2006); In Re Enter. Indus., Inc., 259 B.R. 163 (Bankr. N.D. Cal. 2001); and In Re William E. Johnson, 1998 WL 34066154 (Bank. Court, S.D. Georgia, 1998). Under the close nexus doctrine, the key factors in obtaining PMSI status are the intent of the parties and the temporal proximity of the funding and acquisition.

583 See In Re Peaslee, supra; In Re Myers, 393 B.R. 616 (Bankr. S.D. Ind. 2008). But see In Re Penrod, 392 B.R. 835 (B.A.P. 9th Cir. 2008).

584 See U.C.C. § 9-103 cmt. 3.

585 See U.C.C. § 9-324(a). Neither the security agreement nor the financing statement need recite that the loan is a PMSI. See, In Re Saxe, 491 B.R. 244 (Bankr. W.D. Wis. 2013).

If the secured party files the financing statement within the twenty-day period required, it is deemed to have been perfected before or contemporaneously with the delivery of the collateral to the debtor. This rule provides a complete defense to any attack by a bankruptcy trustee under a preference claim in the event of a bankruptcy filing by the debtor within 90 days of the delivery of the collateral.[586] Thus, a PMSI is an extremely valuable tool for both the debtor and secured party, enabling the debtor to acquire new assets and the secured party to trump a previously filed all asset lien secured party while also insulating itself from potential preference claims in a subsequent bankruptcy.

A dispute may arise as to when the debtor "receives possession of the collateral," if the collateral is delivered in installments. Where the debtor "buys goods and takes possession of them in stages, and then assembly and testing are completed ... at the debtor's location ... the buyer 'takes possession' when after inspection of the goods in the debtor's possession, it would be apparent ... that the debtor has acquired an interest in the goods taken as a whole."[587]

If the debtor has possession, but only as a leasee or on a trial basis, the issue is more complicated. At least one court has held that the twenty-day grace period runs from the time the debtor had the right to purchase the equipment.[588]

A dispute may also arise when the collateral is a titled vehicle. Tendering the application with the proper fee, should generally perfect the lien.[589] Article 9 provides, however, that a vehicle is not "covered' by a certificate of title law until a valid application is made and the proper fee tendered.[590] Practitioners must closely review the applicable state title statute to determine whether perfection occurs when the lien is noted on the title or when the secured party submits the paperwork.

---

586 The Bankruptcy Code provides a thirty-day grace period, effectively allowing ten more days then the Article 9 PMSI rules. 11 U.S.C. § 547(2)(A).

587 See U.C.C. § 9-324 cmt. 3. Official Comment 3 to Section 9-324 of the U.C.C., new to the Code with the 2001 revision, defines when a debtor receives possession of the collateral. In Re Piknik Prods. Co., Inc., 346 B.R. 863 (Bankr. M.D. Ala. 2006), the Court applied this new Revised Article 9 standard. In July 2005, Crouch delivered and bolted to the floor the "majority" of a Juicy Juice System. It contended that the system had not been fully installed at the time and was not operational. The Court rejected Crouch's claim to purchase-money creditor status. The Court emphasized that the majority of equipment had been delivered and installed and that whether the equipment was operational was not the standard. Rather, the test for "receipt of possession under § 9-324 is the impression of a potential lender regarding the debtor's interest in the property." Id. at 867.

588 See Brodie Hotel Supply, Inc. v. United States, 431 F.2d 1316 (9th Cir. 1970).

589 See U.C.C. § 9-311 cmt. 5.

590 See U.C.C. § 9-303(b).

PRACTICE TIP: It is always best that the secured party tenders the loan proceeds directly to the seller/vendor of the collateral to remove all doubt that the value was used to "acquire" the collateral. If the debtor has already provided a deposit or partial payment to the seller, it is advisable that the secured party pay the seller in full and the seller refund the deposit or partial payment to the debtor, rather than for the secured party to refund the debtor directly.

When there are multiple PMSI lenders, the priority conflict will be resolved as follows:

i. A seller's PMSI has priority over that of a lender.[591]
ii. As between conflicting sellers or lenders, the first to files wins.[592]

(See Fixtures and Obtaining a PMSI in Inventory and obtaining a PMSI in Livestock infra for perfection of a PMSI in Fixtures, Inventory and Livestock.)

Finally, as noted, one cannot obtain a PMSI in software unless the software is acquired in a transaction in which the secured party also obtains a PMSI in the goods in which the software is to be used.[593] Note that the secured party must separately identify the software in the financing agreement and file a financing statement, even if the PMSI in the goods was automatically perfected, such as in a consumer goods transaction.

PRACTICE TIP: Because the 20 day period for filing the financing statement runs from delivery of the collateral to the debtor the secured party should consider two practices to shield the PMSI from attack. First, whenever possible, pre-file the financing statement. Article 9 specifically authorizes pre-filing. Thus, do not wait for delivery of the collateral but file as soon as the documents are executed and before delivery is even scheduled. Second, be sure to obtain and retain copies of all delivery documents, including copies of invoices, purchase orders, and bills of lading. Without these documents the secured party is vulnerable to the claim of the prior filed all asset secured party. The latter will not accept a claim of a PMSI, without putting a putative PMSI secured party to its proofs.

591 See U.C.C. § 9-324(g)(l).
592 See U.C.C. §§ 9-322(a), 9-324(g)(2).
593 See U.C.C. § 9-324(f).

(i) *The Transformation Doctrine*

Under the transformation doctrine, courts in the past have denied PMSI status under certain circumstances: (1) when the secured party and debtor cancel the original agreement and replace it with a new loan;[594] (2) PMSI loan is consolidated with a non-PMSI loan;[595] and (3) a secured party agrees to modify the original loan and advance new money.[596]

The 1999 revisions to Article 9 eliminated the transformation doctrine in non-consumer transactions.[597] For commercial transactions Article 9 adopts the "dual-status" approach, preserving the PMSI status and recognizing the loan as having a dual-status, even if: (1) the PMSI collateral also secures a non PMSI obligations; (2) non-PMSI collateral also secures the PMSI; and (3) the PMSI has been renewed, refinanced, consolidated or restructured.[598] These "safe harbor" rules are not binding in bankruptcy court as the bankruptcy code has its own PMSI law under section 522(f), but they may be persuasive.

As for allocating the payments between the PMSI and non-PMSI loans, Article 9 provides that the payments are to be allocated as follows:

(1) In accordance with any reasonable method of application to which parties agree;
(2) In the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or
(3) In the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:
    a. To obligations that are not secured; and
    b. If more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred. [599]

The burden of proof lies with the party claiming PMSI status.[600] Curiously, § 9-103(e)(3) addresses the cases where there are secured and unsecured obligations and where

594 See In Re Matthews, 724 F.2d 798 (9th Cir. 1984).

595 See In Re Manuel, 507 F.2d 990 (5th Cir. 1975).

596 See Pristas v. Landaus of Plymouth, Inc., 742 F.2d 797 (3d Cir. 1984).

597 See U.C.C. § 9-103.

598 See U.C.C. § 9-103(f). See also In Re Saxe, supra. The secured party should avoid each of these situations in any consumer transaction.

599 See U.C.C. § 9-103(e).

600 See U.C.C. § 9-103(g).

there are multiple PMSIs, but does not address the case where there is one secured, non-PMSI obligation and a separate PMSI obligation. At least one bankruptcy court has held that where the PMSI and non-PMSI collateral secure the same debt obligations, the PMSI is not satisfied until the whole debt is satisfied, reasoning, inter alia, that the U.C.C. and the Bankruptcy Code provide for preferential treatment for PMSIs.[601]

For consumer transactions, Article 9 leaves the states to decide whether to follow the dual-status rule and provides that the adoption of the dual-status rule for non-consumer transactions does not create any inference in favor of the rule for consumer transactions.[602] The courts appear to be split on this issue in consumer transactions.[603]

(ii) *Obtaining a PMSI in Inventory*

(a) The rules governing obtaining a PMSI in inventory differ from those pertaining to PMSIs in other goods. There are a few significant limitations on inventory liens. A secured party can only obtain a PMSI in inventory, if:

1. The purchase-money security interest is perfected (so lien must have attached too![604]) when the debtor receives possession of the inventory (not within 20 days after delivery!);
2. The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;[605]
3. The holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory;[606] and

601 See In Re Saxe, supra. But see Lewiston State Bank v. Greenline Equip., L.L.C., 147 P.3d 951 (Utah Ct. App. 2006) (payment of prior PMSI loan and release of that security interest and new non-PMSI loan extinguished prior PMSI).

602 See U.C.C. § 9-103(h).

603 See Alan M. Christenfeld & Aleksandra Kopec, *Purchase Money Security Interests* 41 UCC L.J. 3, 291 (Winter 2009).

604 Thus, the security agreement must be executed granting the lien and the grant of the security interest should be effective upon delivery and/or possession, not upon acceptance and inspection.

605 This notice must only be sent if the conflicting secured party filed a financing statement before the PMSI became perfected, through a filing or on a temporary basis. U.C.C. § 9-324 cmt. 5.

606 The secured party must provide new notices at least every five years, including in connection with the filing of any continuation statement. U.C.C. § 9-324(b)(3).

4. The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.[607]

Note that the requirements listed in (2) through (4) apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory, before the date of the filing; or was temporarily perfected without filing or possession under Section 9-312(f), before the beginning of the 20-day period thereunder.[608]

Any buyer in due course will buy free and clear of all liens, including a lien in inventory, even a PMSI in inventory. This rule is, of course, essential so the obligor can conduct business in the ordinary course, selling its inventory as any seller would. A buyer should not have to inquire about whether its purchase of goods are subject to a lien. However, the buyer in due course must take possession of the goods to prevail over the secured party.[609]

To the extent the proceeds become money in the bank, that is, a deposit account, the bank or any secured party with control over the deposit account will prevail over the inventory lien holder.[610] Moreover, a PMSI in inventory only has priority over chattel paper and instruments constituting proceeds and proceeds of the chattel paper and instruments, to the extent approved in U.C.C. § 9-330, and in other identifiable "cash" proceeds received on or before delivery of the inventory to the buyer.[611] Notably, a

607 See U.C.C. § 9-324(b)(1)–(4). The description in the notice of the items should, when possible, be more specific than just "inventory." Many PMSI lenders will include a very broad definition and then one a bit more narrow, such as, "including without limitation, vehicles or construction equipment and all accessions or attachments." Like the liberal notice filing standard for financing statements, however, the courts generally allow the secured party substantial leeway. Fedders Fin. Corp. v. Chiarelli Bros., Inc., 289 A.2d 169 (Pa. Super. 1972) (notice including many types of inventory upheld although PMSI only in one type); In Re S. Vt. Supply, Inc., 58 B.R. 887 (Bankr. D.Vt. 1986) (court applies "notice filing" standard); In Re Daniels, 35 B.R. 247 (Bankr. WD. Okla. 1983). The notices should also reference subsequent shipments. See also Steven L. Sepinuk, *PMSI Notification What To Say and How To Say It,* TRANSACTIONAL LAW. (Gonzaga Law Commercial Law Ctr., Spokane, Wash.), Aug. 2011, at 1.

608 See U.C.C. § 9-324(c)(1) and (2).

609 See U.C.C. § 9-320.

610 See U.C.C. § 9-327.

611 See U.C.C. § 9-324(b). "On or before delivery" may include payment received "two or three" days after delivery where payment was contemporaneous under the circumstances. Kunkel v. Sprague National Bank, 128 F. 3d 636 (8th Cir. 1997). The "on or before delivery" language was intended to give account financers priority over inventory financers. Id at 28. Thus, the issue is really one of whether the sale created an account receivable or was a cash sale. Id.

PMSI priority in inventory proceeds does not extend to accounts or cash payments received after delivery of the inventory to the buyer.

A consignor's interest in inventory is treated like a PMSI and must be perfected like one, even if it is a true consignment. While a true consignment does not require an authenticated security agreement, both a true consignment and a non-true consignment must comply with the filing requirements of Article 9.

Article 9 adopted a special rule for the interplay of inventory and cross-collateralization paragraphs, allowing a PMSI in inventory, under certain circumstances, even when the inventory collateral was not actually purchased with the funds that remain due and owing. Under this provision, the inventory lender retains its PMSI for its full balance even though some of the inventory is re-sold by the debtor, and, thus, the remaining inventory actually secures funds that were not advanced for the purchase of these items, but were advanced for the purchase of the items that were re-sold by the debtor.[612] When and if, however, the PMSI monetary obligation is paid in full and the security interest in the PMSI collateral remains, the secured party will lose PMSI status if the only remaining outstanding obligation was not a PMSI obligation.[613]

Finally, the vendor should be reminded that when titled vehicles are held as inventory, placing a lien on the title is not sufficient to perfect a lien in the vehicle. The secured party must comply with Article 9's inventory perfection rules, including those for obtaining a PMSI. See definition of "Titled Vehicles" and "Inventory", supra for a detailed description of when titled vehicles are deemed inventory.

(iii) *Buyers/Lessees/Licensees in the Ordinary Course of Business*

A buyer in the ordinary course ("BIOC") buys free and clear of the inventory lien. Pursuant to U.C.C. Section 1-201(b)(9), this means "a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person ... in the business of selling goods of that kind." This section further provides that, "a person buys goods in the ordinary course if the sale to the person comports with the usual or customer practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices." Id.

Thus, to qualify as a BIOC the purchaser must meet four requirements: (1) It must be a "buyer" of goods; (2) It must acquire the goods in good faith and without knowledge that the sale violates any security interests, (3) it must buy from one who is in the

612 See U.C.C. § 9-103.

613 See U.C.C. § 9-103 cmt. 4.

business of selling goods of that kind, and (4) it must buy in accordance with industry practices or the seller's practices.

Buyers for cash or credit qualify.[614] A buyer does not, however, include a transfer by way of a security interest or a transfer in total or partial satisfaction of a debt.[615] The buyer must provide new value.[616] Thus, "buyers" do not include secured parties, lien creditors, or any other creditor who receives the goods in satisfaction of a pre-existing debt.

The buyer must have taken possession of the goods.[617] If the goods are in the possession of the secured party pursuant to U.C.C. § 9-313, the buyer does not take free of the security interest.[618] Courts have, however, held that constructive possession will suffice.[619] Article 9 provides that the buyer must take possession or have right to the goods under Article 2.[620] At least one court, however, held that a buyer taking possession under common law will qualify.[621]

The 1999 revisions to Article 9 broadened the definition of goods sold in the ordinary course to include a sale that is customary in the industry or that was reasonably predictable. Specifically, § 1-201(9) provides as follows:

A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices.[622]

The 1999 revisions to Article 9 also made clear that this policy will apply to lessees of goods in the ordinary course[623] as well as to a licensee in the ordinary course of business of a general intangible created by a licensor.[624]

---

614 Fifth Third Bank of W. Ohio v. Chrysler Fin. Co., 2000 WL 1513926 (Ohio Ct. App. Oct. 13, 2000).

615 See U.C.C. § 1-201(b)(9).

616 See James J. White & Robert S. Summers, UNIFORM COMMERCIAL CODE § 881 (4th ed. 1995).

617 See U.C.C. § 9-320.

618 See U.C.C. § 9-320(e).

619 See In Re W. Iowa Limestone, Inc., 538 F.3d 858 (8th Cir. 2008).

620 See U.C.C. § 1-201(9).

621 See In Re Havens Steel Co., 317 B.R. 75 (Bankr. W.D. Mo. 2004).

622 See also 73 A.L.R. 3d 388 ("As a generalization it may be noted that the courts appear to give a generally liberal interpretation to the phrase "person in the business of selling goods of that kind" in order to carry out the purpose of UCC § 9-307(1) which has been stated to be to protect the buying public in cases where the secured party finances inventory which is sold to the public by the debtor in the regular course of the debtor's business, the courts noting that the underlying philosophy of the UCC is to protect the security interest so long as it does not interfere with the normal flow of commerce.")

623 See U.C.C. § 9-321(c).

624 Id.

As noted above in the definition of titled vehicles and the PMSI section, when titled vehicles are held as inventory, a secured party does not perfect its liens by recording same on the title, but rather through filing and notice under Article 9. This aspect of Article 9 can conflict with state Certificate of Title laws when it comes to the BIOC. Article 9 provides the BIOC of any inventory, including a vehicle titled, takes free and clear of liens on the seller. This result may not reconcile with all state Certificate of Title laws.[625]

Finally, the BIOC may only buy free and clear of liens created by its seller, but not liens created by prior owners unless the prior owner's lienholder entrusted the collateral to the seller. See, Secret Liens Section, and Footnote 754, infra.

(iv) *Obtaining a PMSI in Livestock that are Farm Products*

Article 9 has a special provision for livestock that are farm products.[626] Under this provision, a PMSI in livestock will have priority over the livestock and its identifiable products and proceeds if:

1. The purchase-money security interest is perfected when the debtor receives possession of the livestock (like inventory, no 20-day grace period!);
2. The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;
3. The holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock;[627] and

625 See La Gar Mktg., Inc. v. W. Fin. & Lease, Inc., 2012 WL 4898785 (Ohio Ct. App. Oct. 17, 2012) (BIOC's interests held to be subordinate to Article 9 secured party where BIOC never received Certification of Title); Bank One Tex., N.A. v. Arcadia Fin. Ltd., 219 F.3d 494 (5th Cir. 2000) (BIOC subordinate where debtor never delivered Certificate of Title). See also Official Comment 4 to U.C.C. Section 9-311, which provides that Article 9 supersedes state title statutes that require delivery of a Certificate of Title for perfection, where titled vehicles are inventory. But see Arthur Glick Truck Sales, Inc. v. Stuphen E. Corp., 914 F. Supp. 3d 529 (S.D.N.Y. 2012) (BIOC's interest superior although not yet received Certificate of Title); First Nat'l Bank of El Campo v. Buss, 143 S.W.3d 915 (Tex. App. 2004) (BIOC's interest superior even without Certificate of Title); Jones v. Mitchell, 816 So.2d 68 (Ala. Civ. App. 2001) (BIOC's interests superior).

626 See U.C.C. § 9-324(d).

627 The secured party must send notices at least every six months.

4. The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in livestock of the debtor and describes the livestock.[628]

While the livestock PMSI section parallels the inventory PMSI, the notification to holders of conflicting security interests must be received within six months before the debtor receives possession, as opposed to five years in the case of inventory. A livestock secured party's PMSI priority also extends to all identifiable products and proceeds, while an inventory secured party's PMSI only extends to proceeds that are chattel paper or instruments, to the extent authorized in U.C.C. § 9-330, and in identifiable cash proceeds if the proceeds were received on or before delivery of the inventory to the person who buys them from the debtor.[629] Finally, a PMSI in livestock's priority in proceeds includes identifiable products as well as all proceeds.[630]

As for notification to other secured parties, as with inventory, the parties entitled to notification are secured parties who filed a PMSI filing before the date of the filing or that are temporarily perfected under U.C.C. § 9-312(f).

Again like inventory, even if the secured party is not required to send notification to any parties, it must still perfect before the debtor receives possession of the livestock to qualify for the PMSI.[631]

Finally, "farm products" includes aquatic goods.[632] Curiously, however, the definition is written such that aquatic goods might be "crops" or "livestock." If the aquatic goods are crops, the general inventory rules apply; if they are "livestock" the rules set forth in this section apply. For example, kelp (seaweed) would come within the definition of crops, and catfish would be considered livestock.

(v) ***Manufactured Homes*** – A PMSI will trump a construction lien.[633]

628 See U.C.C. § 9-324(d)(1)–(4).

629 See U.C.C. § 9-324 cmt. 10.

630 See U.C.C. § 9-324 cmt. 10 and 11.

631 See U.C.C. § 9-324(d) and (e).

632 See U.C.C. § 9-102(a)(34). See also, Footnotes 242 and 249, supra.

633 See U.C.C. § 9-334(e)(4).

(H) Temporary Perfection

Temporary perfection rules create a PMSI-type exception to the general priority rules. There are four[634] circumstances when temporary perfection may arise: (1) As a security interest perfected in proceeds for 20 days (even if the original lien was not perfected through the filing of a financing statement); (2) with instruments, certificated securities and negotiable documents, a secured party that gives new value pursuant to a written security agreement has a perfected lien for twenty days without filing;[635] (3) with negotiable documents or goods in possession of a bailee without a negotiable document, the security interest remains perfected for 20 days even when the secured party gives the debtor the goods or the documents representing the goods for the purpose of (a) ultimate sale or exchange or (b) loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange;[636] and (4) to facilitate transactions, a secured party with possession may need to release possession without losing perfection, and thus, a secured party that has possession does not lose possession and remains perfected if the secured party gives possession to a party other than the debtor or lessee if the third party is instructed, before or contemporaneously with the delivery, that it must hold the collateral for the secured party's benefit or redeliver it.[637] During each of these twenty-day periods a perfected lien exists albeit possibly in secret, much like a PMSI.

With instruments, if the instrument is negotiable and the new lender takes possession, the new lender could also claim the status of holder in due course, and it would take free and clear of any lien of which it was unaware.[638]

In the case of a document, if it is negotiable the new lender could also achieve the status of holder in due course through "due negotiation."[639] In this case, however, the negotiation must have been in the ordinary course of the transferor, and the new lender must have acted in good faith and not have notice of any adverse claim. Absent these two exceptions, if the original lender continues its perfection by filing within the

634 Arguably, there may also be lien perfections that are tantamount to temporary perfections where the debtor changes it name or there is a "new debtor," and the original secured creditor perfects its original lien within the time prescribed, such as four months of a location change. See Maintaining Perfection and Priority When Circumstances Change Post-Closing, Chapter III (D), supra.

635 See U.C.C. § 9-312(e).

636 See U.C.C. § 9-312(f)(1) and (2).

637 See U.C.C. § 9-313(h).

638 See U.C.C. § 3-313(a).

639 See U.C.C. § 7-501(1) and (4).

twenty-day period, the original creditor will prevail. Thus, to protect itself, the new lender must thoroughly investigate the transactional source of certificated securities, instruments and negotiable documents.

(I) Accessions

Priority disputes between a secured party claiming an interest in the whole versus a secured party claiming an interest in an accession is governed by Article 9's general priority rules, including the PMSI rules.[640]

The exception is an accession to a whole when the security interest in the whole is perfected under a certificate of title statute. In this case, the security interest in the accession is always subordinate to a perfected secured interest in the whole,[641] except in the case of a true lease under Article 2A. Finally, this rule governs priority amongst secured creditors, and thus probably cannot be invoked by a judgment lien creditor, such as levying creditor who levies on a titled vehicle or a trustee where there is no lien on the title.[642]

PRACTICE TIP: Whenever financing an accession to a motor vehicle or other certificate of title goods, obtain a subordination from a secured party with a lien in the whole.

(J) Fixtures and Crops

(i) ***Fixtures:*** A secured party must timely perfect a fixture filing to have priority over the landowner and mortgagee with regard to goods that are affixed to real property. A mortgage which satisfies the requirements of § 9-502(c) is also effective as a fixture filing. Trade fixtures do not require a fixture filing, but rather only require a regular filing. A secured party retains priority in trade fixtures so long as it has perfected its lien for non-fixture goods before the goods became fixtures.[643] Thus, there are three ways to perfect a lien against fixtures. For trade fixtures only a regular centrally filed financing statement is required. For non-trade fixtures, a fixture filing or mortgage meeting the requirements of a fixture filing must be filed. Notably, the regular trade fixture filing and the fixture filing are effective

640 See U.C.C. § 9-335(c).

641 See U.C.C. § 9-335(d).

642 Id.

643 See U.C.C. § 9-334(e)(2).

for five years, unless extended, but a mortgage filing is effective until it is released.[644]

Article 9 recognizes three categories "of goods" for purposes of fixtures, as follows:

1. "Goods that retain their chattel character entirely and are not part of the real property";
2. "Ordinary building materials that have become an integral part of the real property and cannot retain their character for purposes of finance"; and
3. "An intermediate class that has become real property for certain purposes, but as to which chattel financing may be available."[645]

Filing a mortgage will perfect a lien with respect to categories (1) and (3), if it indicates the goods it covers, the goods are or are to become fixtures, the filing satisfies the requirements of a financing statement and the mortgage is duly recorded.[646] If a secured party is unsure whether the collateral is a fixture, it may make a precautionary filing without the filing being regarded as an admission.[647]

A secured party may obtain a PMSI in fixtures. To have priority over pre-existing liens, a fixture filing must be made before the goods became fixtures or within twenty days thereafter, and the debtor must either have an interest in the real property or be in possession it.[648] However, a PMSI in fixtures is not superior to a subsequently obtained interest unless the PMSI is actually of record before the subsequent lien. The 20-day grace period does not have the same effect in this instance as a PMSI in goods.[649] Moreover, unlike the case of manufactured homes, even a PMSI in fixtures will be junior to a construction mortgage or a permanent mortgage if it was provided to refinance the construction mortgage.[650] But the priority of the construction mortgage is limited to goods that become fixtures during the construction process. If the

644 See U.C.C. § 9-515(g).

645 See U.C.C. § 9-334 cmt. 3. See also Motorola Commc'ns & Elecs., Inc., v. Dale, 665 F.2d 771 (5th Cir. 1982); Bank of Valley v. U.S. Nat'l Bank of Omaha, 341 N.W.2d 592 (Neb. 1983); Parsons v. Lender Serv., Inc., 801 P.2d 739 (Okla. Civ. App. 1990).

646 See U.C.C. § 9-502(c).

647 See U.C.C. § 9-502 cmt. 6.

648 See U.C.C. § 9-334(d).

649 See U.C.C. § 9-334(e)(1).

650 See U.C.C. § 9-334(h).

goods become fixtures after the construction process, the PMSI in fixtures will have priority.

The secured party will also prevail against a claim that a good is a fixture, even if unperfected, if "the debtor has a right to remove the goods as the encumbrances or owner."[651] Thus, when the debtor's real property lease provides it may remove trade fixtures at the conclusion of the lease, this right inures to the benefit of the secured party.[652] Indeed, this right of the secured party continues for a "reasonable time" even after the debtor's right to remove the goods is terminated.[653] Finally, the secured party has priority in fixtures when the encumbrancer or owner "has, in an authenticated record, consented to the security interest or disclaimed an interest in the goods as fixtures."[654] Thus, Article 9 expressly authorizes landlord and mortgagee waivers.[655]

(ii) ***Crops:*** A perfected security interest in crops has priority over an owner or mortgagee or others claiming under real property law.[656]

(iii) ***Trade Fixtures*:** Trade fixtures present a special situation because they are generally installed by a tenant for its own use and are intended to be removed by the tenant at the conclusion of the lease. As noted above, if goods are trade fixtures, the secured party will generally prevail over the landowner even if the trade fixtures have been affixed to the real property, so long as the secured party is perfected under Article 9 before the trade fixtures become affixed.[657]

PRACTICE TIP: The determination of whether an item is a trade fixture or a non-trade fixture is often fact-sensitive and may be costly to prove. Accordingly, a secured party should make a fixture filing whenever goods are to be affixed to real property. U.C.C. § 9-334(e)(2).

651 See U.C.C. § 9-334(f)(2).
652 Id.
653 See U.C.C. § 9-334(g).
654 See U.C.C. § 9-334(f)(1).
655 Id.
656 See U.C.C. § 9-334(i).
657 See U.C.C. § 9-334(e)(2)(A)(C).

(K) Priority of Liens In Proceeds

As noted above, Article 9 has an expansive definition of "proceeds"[658] and security interests generally continue to be perfected in the proceeds of the collateral for twenty days.[659] Pursuant to U.C.C. § 9-315(d), the perfection of the lien in proceeds continues even longer under the following circumstances:

(1) The following conditions are satisfied:
   a. A filed financing statement covers the original collateral;
   b. The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and
   c. The proceeds are not acquired with cash proceeds.

(2) The proceeds are identifiable[660] cash proceeds; or

(3) The security interest in the proceeds is perfected other than under subsection (c) (the automatic perfection in proceeds rule) when the security interest attaches to the proceeds or within 20 days thereafter.[661]

Thus, under sub-section (2) above, the lien automatically continues in proceeds for twenty days and the lien in identifiable cash proceeds continues indefinitely even if the security interest in the original collateral remains unperfected.[662] Cash proceeds are "proceeds that are money, checks, deposit accounts, or the like."[663] Proceeds that are commingled with other property are identifiable proceeds "to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to

---

658 See U.C.C. § 9-102(a)(64).

659 See U.C.C. § 9-315(c). But see, Section (G) (ii) supra, for the limits of a continuing PMSI in inventory proceeds.

660 Proceeds not "identifiable" where only $1.3 million of deposit accounts $5.3 million came from liquidation of accounts receivables. Madisonville State Bank, N.A. v. Citizen's Bank of Tex., N.A., 184 S.W.3d 835 (Tex. App. 2006); see also Orix Fin. Servs., Inc. v. Kovacs, 83 Cal. Rptr. 3d 900 (Cal. Ct. App. 2008) (judgment creditor is transferee which did not act with collusion).

661 See U.C.C. § 9-315 is not limited to non-titled collateral, but applies to proceeds of liens perfected in titled collateral as well. U.C.C. § 9-315 cmt. 6.

662 See U.C.C. § 9-315(d)(2). In many cases, a purchaser or other transferee of the cash proceeds will take free of the perfected security interest in proceeds. Id., § 9-315 cmt. 7. See, e.g. U.C.C. § 9-330(d) (purchaser of check), U.C.C. § 9-331 (holder in due course of check), U.C.C. § 9-332 (transferee of money or funds from a deposit account), U.C.C. § 9-315(d)(2).

663 See U.C.C. § 9-102(a)(9).

the commingled property of the type involved."[664] This perfection in identifiable proceeds has even been held to continue upon a bankruptcy filing of the debtor.[665] Notably, however, but this perfection is limited to proceeds of original collateral: it does not extend to cash proceeds of non-cash proceeds of original collateral.[666]

Under subsection (1) of 9-315(d), the lien in non-cash proceeds continues if a filed financing statement covers the original collateral, one would perfect in the proceeds collateral by filing in the same locale that the secured party filed in, and the proceeds are not acquired with cash proceeds.[667] A good example of the application of this section is set forth in Example 5 of the Official Comments to Section 9-322. In this example, secured creditor A files against inventory on May 1, and secured party B files against accounts on June 1 of the same year. Secured party A's lien in proceeds of the inventory will trump secured party B's lien in accounts. This exception is, however, very limited in the real world because it only applies if the proceeds are not acquired with cash proceeds, and "cash proceeds" include "money, checks, deposit accounts, or the like."[668] In the real world, most assets acquired subsequent to disposition of the original collateral will be acquired with money or checks, such as where inventory is sold and the money, in the form of cash or a check is used to acquire equipment. Thus, in application this exception is generally limited to a direct exchange of one type of collateral for another without cash collateral, such as a direct equipment-for-equipment exchange and accounts as proceeds of inventory.

Finally, under subsection (3) of 9-315(d), the lien in non-cash proceeds continues if the security interest in the proceeds is perfected independently. Under this exception, the all-asset secured party may often claim priority in subsequently acquired collateral, such as where inventory is sold and the money (or a check) is used to purchase equipment.

PRACTICE TIP: The secured party without an all asset filing should be sure to include broad "proceeds" language in its financing statement, such as "...all products and proceeds of any of the foregoing including but not limited to, all assets and personal property constituting proceeds or proceeds of proceeds of the collateral described above." The secured party should also consider filing a fixture filing,

664 See U.C.C. § 9-315(b)(2).

665 See In Re Schwinn Cycling & Fitness, Inc., 313 B.R. 473 (D. Colo. 2004).

666 See U.C.C. § 9-315(d) cmt. 7.

667 See U.C.C. § 9-315(d)(1).

668 See U.C.C. § 9-102(a)(9).

even though the original collateral is not fixture, in case any proceeds of the original collateral becomes fixtures.

As illustrated above, the continuation of the lien in proceeds can cause some very complex priority problems, and this becomes especially true when there is a conflicting security interest in the collateral to which the proceeds have been recast. As previously noted, priority is generally based on the first to file or perfect.[669] For purposes of proceeds, the time of filing or perfection in the original collateral "is also the time of filing or perfection ... in proceeds."[670] Of course liens in proceeds are still trumped by a secured party that perfects a security interest in original collateral with a control agreement (or the depository bank) where the proceeds are placed into a deposit account, or investment property, or a letter of credit or where the competing claim has priority as a purchaser of chattel paper or an instrument under Articles 3, 7 or 8.[671]

Because Article 9 is primarily a notice system, the drafters were concerned about a secured party that perfects without filing having priority in proceeds in all collateral, including collateral where the secured parties generally rely upon a lien search. Thus, for purposes of priority in proceeds, Article 9 distinguishes between what the Official Comments call "non-filing collateral" and filing collateral. "Non-filing collateral" is defined as those types of collateral that may be perfected by a method other than filing and for which secured parties generally do not conduct UCC searches.[672]

If a secured party perfects in non-filing collateral through a method other than filing, the proceeds of such collateral will have the same priority only if: (1) the security interest in proceeds is perfected; and (2) the proceeds are cash proceeds or of the same type as the collateral (such as a promissory note and a draft, both of which are instruments); and (3) "in the case of proceeds that are proceeds of proceeds, all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral."[673]

Thus, if the security interest in proceeds is perfected, there are two cases in which the secured party with priority in non-filing collateral will not automatically have priority in the proceeds: (1) when the proceeds of proceeds end up in filing collateral and (2) when the proceeds end up in non-filing collateral, but they went through filing collateral

669 See U.C.C. § 9-322(a)(1).

670 See U.C.C. § 9-322(b)(1).

671 See U.C.C. §§ 9-322(c), 9-327, 9-328, 9-329, 9-330 and 9-331.

672 See U.C.C. § 9-322(d). Non-filing collateral includes chattel paper, deposit accounts, negotiable documents, instruments, investment property or letters of credit. U.C.C. § 9-322 cmt. 8.

673 See U.C.C. § 9-322(c)(2)(C).

in their journey to the current form of non-filing collateral. Article 9 summarizes the rule as follows: If the original security interest was in non-filing collateral and was perfected other than through filing and the proceeds are currently not cash proceeds or non-filing collateral except for a deposit account (basically filing collateral), priority in the proceeds will be based upon the first to file, not the first to file or perfect.[674] This is scenario (1) above. Under scenario (2) above, priority reverts to the first to file or perfect.[675]

In other words, the secured party that perfected in non-filing collateral through a method other than filing retains its priority in the proceeds of its collateral if the ending collateral is non-filing collateral, the security interest in the proceeds is perfected and all intervening collateral was cash proceeds, proceeds of the same type as the original collateral or an account relating to the collateral. But if the proceeds of the non-filing collateral are ultimately found in the form of filing collateral, priority is according to priority at the time of filing, not filing or perfection.[676] Even if the proceeds of the non-filing collateral are ultimately found in the form of non-filing collateral and are cash or collateral of the same type or an account relating to the collateral, the non-filing secured party retains its priority in the proceeds only if no non-cash proceeds, proceeds of a different type or filing collateral intervened in the chain, in which case the first to have filed or perfected rule governs.[677]

This complicated priority scheme for battles between filing secured creditors and non-filing secured creditors can perhaps be best understood when one looks at the architecture of 9-322. Subsection (a) provides that priority will be based upon the first to file or perfect. Subsection (b) provides that the time for perfection in proceeds is the time of perfection in the original collateral. Subsection (c) provides that under certain circumstances subsection (a) is superseded and the non-filing secured creditor will have priority in proceeds, regardless of who perfected first. (e.g. when the ending proceeds are non-filing collateral and in their journey the proceeds were never in filing collateral). Subsection (d) provides that in certain circumstances subsection (a) is superseded and the filing secured creditor will have priority regardless of who perfected first (e.g. where the proceeds are filing collateral). Subsection (e) provides that under certain circumstances, a battle between a non-filing secured creditor and a filing secured creditor will not be governed by subsections (c) or (d), but will revert back to subsection (a) where the first to file or perfect wins. (e.g. where the ending proceeds are in non-filing collateral but in

674 See U.C.C. § 9-322(d) and (e).

675 See U.C.C. § 9-322(c), (d) and (e).

676 See U.C.C. § 9-332(a) and (b).

677 See U.C.C. §§ 9-322(a)(1), 9-322(2)(c), 9-322 (d) and 9-322 (e).

their journey they went through filing collateral). Finally, under subsections (f) and (g), liens accorded priority under the rules stated above are trumped by the following:

> A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides;[678]
>
> - Section 4-210 with respect to a security interest of a collecting bank;[679]
> - Section 5-118 with respect to a security interest of an issuer or nominated person;[680] and
> - Section 9-110 with respect to a security interest arising under Article 2 or 2A.[681]

One notable exception to the complicated priority scheme discussed above relates to chattel paper. [682] A purchaser of chattel paper automatically has priority in proceeds of the chattel paper.[683]

The priority scheme in filing versus non-filing collateral proceeds under 9-322 is best illustrated through Examples 6, 9, 11, 12 and 13 included in the Official Comments to U.C.C. § 9-322, as follows:

> - Example 6. SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. Debtor receives cash proceeds of the security (e.g., dividends deposited into Debtor's deposit account). If the first-to-file-or-perfect rule of subsection (a)(1)[684] were applied, SP-1's security interest in the cash proceeds would be senior, although SP-2's security interest continues perfected under Section 9-315 beyond the 20-day period of automatic perfection. This was the result under former Article 9. Under subsection § 9-322(c), however, SP-2's security interest is senior.

678 See U.C.C. § 9-322(g).

679 See U.C.C. § 9-322(f)(2).

680 See U.C.C. § 9-322(f)(3).

681 See U.C.C. § 9-322(f)(4).

682 See U.C.C. § 9-330 (c) (1) and (2).

683 See U.C.C. § 9-330 (c) (1) and (2).

684 All references to subsection (a)-(e) are to subsections (a)-(e) of U.C.C. § 9-322.

Note that a different result would occur if SP-1 were to obtain control of the deposit account proceeds. This is so because subsection (c) is subject to subsection (f), which in turn provides that the priority rules under subsections (a) through (e) are subject to "the other provisions of this part." One of those "other provisions" is § 9-327, which accords priority to a security interest perfected by control. See § 9-327(1).

Note also that a still different result would occur if the dividend was not cash, but a stock certificate. In such case, SP-2 would lose to SP-1 because the proceeds are not cash proceeds and SP-2's lien will lapse after 20 days. If, however SP-2 had filed it would have prevailed even though it filed after SP-1, under 9-315 (2) (3). Thus, non-filing secured parties should consider filing even though it is not necessary for priority in the original collateral, as it may be determinative of priority in a battle over proceeds.

- Example 9. SP-1 perfects its security interest in instruments by filing. SP-2 subsequently perfects its security interest in investment property by taking control of a certificated security and also by filing against investment property. Debtor receives an instrument as proceeds of the security consisting of a dividend check that it deposits in a deposit account. Because the check and the deposit account are cash proceeds, SP-1's and SP-2's security interest in the cash proceeds are perfected under § 9-315 beyond the 20-day period of automatic perfection. However, SP-2's security interest is senior under subsection (c) of § 9-322.
- Example 11. SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's existing and after-acquired inventory. Debtor uses funds from the deposit account to purchase inventory, which SP-1 can trace as identifiable proceeds of its security interest in Debtor's deposit account, and which SP-2 claims as original collateral. The inventory is sold and the proceeds deposited to another deposit account, as to which SP-1 has not obtained control. Subsection (c) does not govern priority in this other deposit account. This deposit account is cash proceeds and is also the same type of collateral as SP-1's original collateral, as required by subsections (c)(2)(A) and (B). However, SP-1's security interest does not satisfy subsection (c)(2)(C) because the inventory proceeds, which intervened between the original deposit account and the deposit account constituting the proceeds at issue, are not cash proceeds, proceeds of the same type as the collateral (original deposit account), or an account relating to the

collateral. Stated otherwise, once proceeds other than cash proceeds, proceeds of the same type as the original collateral, or an account relating to the original collateral intervene in the chain of proceeds, priority under subsection (c) is thereafter unavailable. The special priority rule in subsection (d) (if proceeds is filing collateral, first to file rules) also is inapplicable to this case. [See Example 13 below.] Instead, the general first-to-file-or-perfect rule of subsections (a) and (b) apply. Under that rule, SP-1 has priority unless its security interest in the inventory proceeds became unperfected under § 9-315(d). Had SP-2 filed against inventory before SP-1 obtained control of the original deposit account, then SP-2 would have had priority even if SP-1's security interest in the inventory proceeds remained perfected.

- Example 12. SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against equipment, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's equipment. SP-1 then files against Debtor's equipment. Debtor uses funds from the deposit account to purchase equipment, which SP-1 can trace as proceeds of its security interest in Debtor's deposit account. If the first-to-file-or-perfect rule were applied, SP-1's security interest would be senior under subsections (a)(1) and (b), because it was the first to perfect in the original collateral and there was no period during which its security interest was unperfected. Under subsection (d), however, SP-2's security interest would be senior because it filed first. This corresponds with the likely expectations of the parties.
- Example 13. SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's existing and after-acquired inventory. Debtor uses funds from the deposit account to purchase inventory, which SP-1 can trace as identifiable proceeds of its security interest in Debtor's deposit accounts, and which SP-2 claims as original collateral. The inventory is sold and the proceeds deposited into another deposit account, as to which SP-1 has not obtained control. As seen above in Example 11, subsection (c) does not govern priority in this deposit account. Subsection (d) also does not govern, because the proceeds at issue (the deposit account) are cash proceeds. See subsection (c). Rather, the general rules of subsections (a) and (b) govern.

Special rules also govern claims to proceeds of a PMSI. The PMSI superiority in inventory extends to (a) chattel paper or an instrument arising from the sale of the inventory and the proceeds of the chattel paper if so provided in U.C.C. § 9-330; and (b) in identifiable cash proceeds, except as otherwise provided for a deposit account, but only if received on or before the delivery of the inventory to a buyer.[685]

A PMSI in livestock has priority in all identifiable proceeds, except as otherwise provided for deposit accounts, and even in identifiable products in their unmanufactured states.[686]

A PMSI in software has priority over identifiable proceeds to the extent the PMSI in the goods in which the software was acquired for use has priority in the goods and proceeds, except, again, as otherwise provided for deposit accounts.[687]

In the event of conflicting PMSIs, a PMSI on the part of the vendor securing all or part of the purchase price has priority over of a PMSI of a lender that enable the debtor to finance the purchase.[688] Otherwise, the general rule of first to file or perfect governs.[689]

Finally, proceeds of a letter of credit may be "proceeds" of some other collateral if the letter of credit was a secondary obligation. So long as the proceeds remain identifiable as cash proceeds, the secured party with a perfected lien in the original collateral also has a lien in the letter of credit proceeds.[690]

A PMSI in goods other than inventory and livestock, such as equipment, has priority over identifiable proceeds, again, except as provided for deposit accounts.[691]

(L) Commingled Proceeds

Unlike accessions, goods are commingled when the identity of the original goods are lost. Where a secured party's proceeds are commingled with other proceeds, Article

685 See U.C.C. §§ 9-324(b), 9-330(e). There may be some room for debate on what constitutes received on or before delivery of the inventory to a buyer. Kunkel v. Sprague National Bank, 128 F. 3d 636 (8th Cir. 1997) (payment "two or three days" after delivery held to be sufficient because statute designed to distinguish between cash and credit sales); Sony Corp. of Am. v. Bank One, 85 F.3d 131 (4th Cir. 1996) (check received from buyer one day after delivery of inventory deemed "reasonably contemporaneous").

686 See U.C.C. § 9-324(d).

687 See U.C.C. § 9-324(f).

688 See U.C.C. § 9-324(g)(1).

689 See U.C.C. § 9-324(g)(2).

690 See U.C.C. §§ 9-109(c)(4), 9-329 cmt. 3.

691 See U.C.C. § 9-324(a).

9 authorizes the "lowest intermediate balance rule" or other "equitable principles" to be applied.[692] Note that a security interest in identifiable cash proceeds is automatically perfected for 20 days, even without a filing on the original collateral.[693]

(M) Commingled Goods

If two items are commingled, and a secured party holds a perfected security interest in one item and no one holds a perfected security interest in the other item, the perfected secured party has priority in the commingled goods.[694] If, however, two or more secured parties held perfected security interests in the items before they become commingled, "the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods."[695]

When similar items of inventory are purchased with co-existing security interests in accounts, such that the receivables cannot be traced to a particular security interest, each secured party has a lien in the inventory and the liens are treated pro-rated.[696]

(N) Erroneous UCC-1 Financing Statement

When a financing statement is filed with incorrect information a subsequent creditor has priority.[697]

(O) Junior Creditor

If a secured party with a junior lien comes into possession of the proceeds of the collateral, such as when a junior creditor with a lien on accounts collects a check, the junior creditor will not be able to defeat the senior lender unless the junior creditor is a

692 See U.C.C. § 9-315 cmt. 3. When the commingled proceeds are in a deposit account, under the lowest intermediate balance rule, the court recreates and reviews the daily balances in the account, each time identifying the timing and source of the funds. It assumes the debtor spent its own money first, leaving behind the secured party's proceeds portion. The secured party is awarded the lowest balance of "pure" proceeds. Sec. State Bank v. Firstar Bank Milwaukee, N.A., 965 F. Supp. 1237, 1244-48 (N.D. Iowa 1997); Gen. Motors Acceptance Corp. v. Norstar Banks, 141 Misc. 2d 349, 354, 532 N.Y.S.2d 685, 688-89 (N.Y. Sup. Ct. 1988); Universal C.I.T. Credit Corp. v. Farmers Bank, 358 F. Supp. 317, 325-27 (E.D. Mo. 1973).

693 See U.C.C. § 9-315(d).

694 See U.C.C. § 9-336(e).

695 See U.C.C. § 9-336(f)(2).

696 See U.C.C. §§ 9-336 and 9-315(b)(2).

697 See U.C.C. § 9-338. See also, Section III(c)(ii), supra.

holder in due course or is not aware its retention of the check violates the rights of the senior lender.[698]

(P) Judgment Lien Creditors

Judgment lien creditors take subject to a secured party's perfected lien in goods, no matter how perfected,[699] and even if the perfection subsequently lapses.[700] Of course, levying lien creditors, however, have priority over unperfected secured creditors. Accordingly, unperfected secured creditors will not trump a civil forfeiture of the debtor's property.[701]

(Q) Subsequent Lien Creditors: Future Advances and After-Acquired Liens

With respect to future advances, the secured party prevails only so long as the advances are made within the later of 45 days after the lien arose or the time the secured party learned of the lien.[702] Thus, in the case of future advances, subsequent lien creditors may obtain priority under certain circumstances. The lender, usually under a revolving credit line or similar financing, continues its priority over subsequent lien creditors;

> For forty-five days; and
> For so long thereafter as the lender has no actual knowledge of the lien; and
> Forever, if the advances are made "pursuant to a commitment" that was entered into without knowledge of the lien.[703]

This section has generated a huge amount of redrafting of standard loan documents to convert them from "discretionary" to "commitment" loan documents while preserving all of flexibility of a "discretionary" loan.

---

698 See U.C.C. §§ 9-330(d), 9-331. See also In Re Jersey Tractor Trailer Training, Inc., 2008 WL 2783342 (D.N.J. July 15, 2008), aff'd in part, vacated in part, 580 F.3d 147 (3d Cir. 2009).

699 See U.C.C. §§ 9-317(a)(2), 9-334(e)(3). Some courts have held that a levying judgment creditor may trump a bank's perfected lien and right of setoff in a deposit account if the bank has not enforced or exercised its rights in the deposit account. See Chapter IV (D)(iii) Deposit Accounts, supra.

700 See U.C.C. § 9-515(c) cmt. 3; U.C.C. § 9-317(a); In Re Stetson & Assocs., Inc. 330 B.R. 613 (Bankr. E.D. Tenn. 2005).

701 See United States v. Two Bank Accounts, 2009 WL 803615 (D.S.D. March 24, 2009).

702 See U.C.C. § 9-323(b).

703 Id.

The IRS, however, has superior rights to those of an ordinary lien creditor. For purposes of IRS tax liens, the after-acquired secured party's priority only lasts for 45 days after the tax lien is properly recorded, and the future advance secured party's priority only lasts for 45 days after the tax lien is properly recorded or the date the secured party learned of the lien, whichever is earlier.[704]

(R) Subordination Agreements

Lien subordinations are common in commercial transactions and are generally approved under Article 9.[705] Such an agreement does not have to be in writing, but must be made by the person entitled to priority.[706] Mere allegations of "knowledge" or "acquiescence" are not enough.[707] An issue arises where two secured parties enter into a subordination agreement, but there are three or more secured parties, one or more of which are not a party to the subordination agreement. The classic example is where A, B and C have liens with A in first position, B in second position and C in the third position, and A subordinates to C. Is C now superior to B? Most courts and commentators adopt the "partial subordination" rule.[708] Under this rule, C steps into A's shoes, but only to the extent of A's lien. Thus, B receives exactly what he expected, a second position behind A's lien, only to the extent of A's lien. Under a competing rule, the "complete subordination" rule, A goes to the bottom, behind B and C, with B and C stepping ahead of A, but with C remaining completely junior to B.[709]

704 See 26 U.S.C. § 6321 (2012).

705 U.C.C. § 9-339. Subordination agreements are enforceable in bankruptcy court to the same extent as under state law. 11 U.S.C. § 510(a) (2012). Indeed, a well drafted subordination (or other intercreditor) agreement should have the junior creditor, inter alia, waive any right to challenge the senior creditor's right in any bankruptcy proceeding to credit bid at a Section 363 sale or to object to a plan of reorganization.

706 See U.C.C. § 9-339 cmt. 2.

707 See Clark & Clark, The Law of Secured Transactions Under the UCC, § 3.10.

708 2 Grant Gilmore, *Security Interests in Personal Property* § 39.1, pp. 1020-21 (1965); George A. Nation III, *Circuity of Liens Arising From Subordination Agreements: Comforting Unanimity No More*, 83 B.U. L. REV. 591 (2003).

709 See AmSouth Bank, N.A. v. J&D Fin., 679 So.2d 695 (Ala. 1996). See also Old Stone Mortg. & Realty Trust v. New Ga. Plumbing, Inc., 239 Ga. 345, 236 S.E.2d 592 (1977).

(S) Miscellaneous Priority Provisions

(i) *Non-Ordinary Course Buyers*

While a non-ordinary course buyer cannot take free of a perfected security interest, a non-ordinary course buyer that gives value and takes delivery of the collateral will prevail over an unperfected secured party unless the non-ordinary course buyer has knowledge of the lien.[710] A non-ordinary course buyer may also trump a perfected lender with respect to subsequent advances.[711] As with subsequent lien creditors, there is a forty-five day rule. In this case, however, the forty-five days is an absolute outside date and it is reduced if the lender learns of the sale during the forty-five day period.[712]

(ii) *Priority of Competing Security Interests with a New Debtor*

If a purchaser becomes bound by a pre-existing security interest in acquired collateral and the purchaser was the subject of a security interest including "after-acquired" collateral, the original security interest is subordinate to that of the purchaser's after-acquired secured party regardless of which party filed first.[713]

(iii) *Non Article 9 Statutory or Common Law Possessory Liens*

Possessory liens such as landlord's and garage keeper's liens generally have priority over Article 9 liens, unless expressly provided otherwise by the applicable statute or common law.[714] The purpose of this rule is to ensure that liens securing claims arising from work intended to enhance or preserve the value of collateral take priority over an earlier security interest even though perfected. However, the priority accorded possessory liens does not apply when a statute allows the lienholder to file a notice of lien and release the property to the debtor.[715] The priority of § 9-333 is also generally limited to "possessory" liens, and does not extend to statutory or equitable non-possessory liens

710 See U.C.C. § 9-317(b). But if the non-ordinary course buyer has knowledge of the lien, a cause of action will lie in conversion. Former TCHR, LLC v. First Hand Mgmt. LLC, 317 P.3d 1226 (Colo. App. 2012).

711 See U.C.C. § 9-323(d) and (e).

712 Id.

713 See U.C.C. § 9-326 cmt. 2.

714 See U.C.C. § 9-333. For a discussion of state specific laws, see Footnote supra.

715 See U.C.C. § 9-333(a).

and[716] even the superpriority of "possessory" liens is lost if the secured party releases possession.[717]

See also Secret Liens Section V infra, for additional non-Article 9 lien priority issues.

(iv) *Landlord's Liens*

When confronted with a landlord's lien claim, the secured creditor should first determine whether the secured creditor's transactional documents include a landlord's waiver. If a landlord's waiver was obtained, the creditor need only produce and remind the landlord of the waiver.[718]

If the creditor does not have a landlord waiver, the creditor should next determine whether the transaction is a true lease. If it is a true lease, the lessor should argue that the landlord cannot have a lien on personal property that the obligor/tenant does not even own.

(v) *Fixture Scenarios*[719]

In addition to asserting a lien on the collateral for unpaid rent, a landlord may alternatively argue that some or all of the collateral has been affixed to the real estate in such a way as to transform the collateral into a fixture that cannot be removed.[720]

---

716 See BancorpSouth Bank v. Hazelwood Logistics Ctr., LLC, 706 F.3d 888 (8th Cir. 2013). The non-possessory lienholder will often cry "equity." Non-possessory liens should not, in the name of "equity," trump Article 9 liens since equitable concepts should only be used when necessary to fill a gap in the U.C.C., and Article 9 specifically gives possessory liens priority and does not give similar treatment to non-possessory liens. U.C.C. § 1-103.

717 See In Re WEB2B Payment Solutions, Inc., 488 B.R. 387 (B.A.P. 8th Cir. 2013).

718 The above discussion relates only to nonconsensual landlord liens, such as those arising automatically under a state, statute. Consensual liens of a landlord are governed by the general priority rules of U.C.C. Article 9 since the landlord becomes merely another Article 9 secured creditor when it obtains a consensual lien on personal property through a security agreement. This section applies equally to mortgagee liens, except, of course, that a landlord lien waiver will not be effective against a mortgagee unless the mortgagee has also waived its lien. Landlord waivers and subordinations are authorized under Article 9 and Article 2A, U.C.C. § 9-334 and 2A-309. A landlord's lien waiver or subordination is also generally binding on the trustee in bankruptcy. See, e.g., 11 U.S.C.A. § 510(a) (2014).

719 Fixtures are specifically exempt from bankruptcy trustee's "strong-arm" powers. 11 U.S.C.A. § 544(a)(3) (2014).

720 Priority disputes in fixtures are governed by the law of the state where the fixture is located. U.C.C. § 9-301(3).

In addressing this claim, as with the nonfixture scenario, the secured creditor should initially determine whether a landlord's waiver was obtained at the inception of the transaction. If the response is in the affirmative, the landlord should be precluded from raising a fixture claim.

The priority rules for fixtures are similar whether the transaction is a true lease or a loan.[721] If a secured creditor has a PMSI and has properly filed and perfected a fixture filing, it should prevail over the landlord as it would against any other junior creditor.[722]

If the secured creditor does not have a landlord's waiver or a fixture filing upon which to rely, it should determine whether the fixtures are "trade fixtures" and review the wording of the obligor's real property lease. If the fixtures are trade fixtures or the real property lease between the obligor and its landlord provides for the unconditional right of the tenant/obligor to remove the collateral upon the termination of the lease, then the Article 9 creditor and Article 2A lessor have a superior position to that of the landlord, based upon a regular secretary of state UCC-1 filing or derivatively through the tenant/obligor, respectively.[723]

(vi) *Garage Keepers' Liens*

A garage keeper's lien (also referred to as a garageman's lien) arises if a mechanic or other garage keeper contends that it has a lien on the collateral and it is entitled to hold the collateral until it has been paid for all repair or storage bills. The law here varies from state to state.[724] Articles 9 and 2A specifically defer to these state laws to the extent they effectuate possessory liens.[725] Many states, like New York, generally

721 Id. § 2A-309 (Article 2A for leases); Id. § 9-334 (Article 9).

722 The Article 9 lender must have filed the fixture filing within twenty days of the date the fixture is attached to the real property, and this period is reduced for the Article 2A lessor (under U.C.C. § 2A-309(4)) to ten days. U.C.C. § 9-334(d); Id. § 2A-309(4). Although a landlord's waiver will protect the creditor against a claim by a landlord, it will not protect against claims by the landlord's mortgagee unless the mortgagee has also waived its claims. Therefore, in the event of a foreclosure by the landlord's mortgagee, any collateral that has become a fixture will be vulnerable if the creditor is relying solely on a landlord's waiver. Thus, if the collateral is potentially a fixture, the creditor should always obtain a landlord waiver, and perfect through a timely filed U.C.C.-l fixture filing, and, if possible, obtain a mortgage waiver as well.

723 See U.C.C. § 9-334 (e)(2) and § 9-334(f).

724 An indispensable summary of state commercial law is the Manual of Credit and Commercial Law, published by the National Association of Credit Management.

725 See U.C.C. § 9-333(b) Id. § 2A-306. Articles 9 and 2A provide that the possessory lien is superior unless a statute creating the lien expressly provides otherwise. An interesting issue arises with possessory liens when the lienholder loses and then regains possession. Bellamy's Inc. v. Genoa Nat'l Bank (In Re Borden), 361 B.R. 489 (B.A.P. 8th Cir. 2007).

provide that garage keeper's liens are superior to those of other creditors.[726] Arizona and New Jersey provide garage keeper's liens in titled motor vehicles are generally inferior to those of Article 9 perfected secured creditors.[727] The validity and extent of the lien often turns on whether the collateral is a titled vehicle and whether the claimed lien is for storage or repairs.[728]

(vii) *Titled Vehicles*

A review of the polar legislation in New York and New Jersey regarding garage keeper's liens highlights the issues that may stymie collection.

As noted above, under New Jersey and Arizona law, if the collateral is a titled vehicle, a claimed garage keeper's lien is subordinated to the lien held by a properly secured creditor. The exception in New Jersey is a true lease. If the transaction is a true lease, the lessee is deemed the agent of the lessor and authorized to consent to repairs, storage, and other charges on behalf of the lessor. In this case, the garage keeper's lien is superior to the rights of the lessor to the extent of all fees and expenses incurred by the mechanic after it has given seven day's written notice to the lessor.

Under New York law, if the collateral is a titled vehicle, the law is almost the exact opposite of New Jersey and the garage keeper's lien is generally superior to the lien held by a perfected secured creditor, so long as the mechanic is registered with the division of motor vehicles as a licensed garage as noted in the section immediately above. If the mechanic is not registered, it does not obtain the lien rights. This lien, like all artisan's liens, is a possessory lien. Once the lienholder gives up possession of the property, it also relinquishes the lien.[729]

In summary, the priority dispute between a garage keeper's lien and an Article 9 lien is generally resolved pursuant to § 9-333. The uniform revision of § 9-333 provides

726 See A.R.S. 33-1022(B) and New York Lien Law § 184 (McKinney 2014). A garage keeper must, however, be a licensed garage with the State of New York in order to invoke New York's favorable lien law. Gen. Motors Acceptance Corp. v. Chase Collision, Inc., 532 N.Y.S.2d 347 (Sup. Ct. 1988) ("here the garageman has failed to provide evidence that it operated a registered repair shop and thus is not entitled to establish or sustain a lien under our Lien Law"); N.Y. Veh. & Traf. Law § 108 (McKinney 2014).

727 See A.R.S. 33-1022(B); N.J. STAT ANN. § 2a:44-21 (West 2014).

728 See Ferrante Equip. Co. v. Foley Mach. Co., 49 N.J. 432 (1967); Mickey's Clan, Inc. v. N.Y. Credit Men's Adjustment Bureau, Inc., 452 N.Y.2d 555 (N.Y. Sup. Ct. 1981).

729 New York law includes an exception to the possession rule which allows the garage keeper to maintain its lien for up to thirty days after releasing possession. NY Lien Law §184(i); ITT Commercial Finance Corp. v. Kallmeyer & Sons Trucking Tire Service Inc. 156 Misc. 2d 505, 593 N.Y.S. 2d 951 (N.Y. Sup. 1993).

"[a] possessory lien or goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise." New Jersey and Arizona, whose statutes expressly provide for priority of the Article 9 lien, are the exceptions. Most states, like New York noted above do not expressly provide for Article 9 priority. Thus, in most states the garage keeper will prevail, although some states may adopt a non-uniform version of U.C.C. § 9-333, thereby giving priority to an Article 9 lien even without a garage keeper's lien statute which expressly so provides. For example, Colorado has adopted a non-uniform version of § 9-333, which is exactly the opposite of the uniform version providing instead that the possessory lien has priority only if the lien created by a statute expressly so provides.[730] As a result in Colorado, where the garage keeper's lien statute is silent as to priority, the Article 9 secured creditor still prevails.[731]

(viii) *Nontitled Vehicles*

Nontitled vehicles are ones that are not authorized to drive on the public roads, such as a tractor or CAT. A garage keeper can generally assert a nonstatutory, common law lien against such vehicles or other equipment. Common law artisan liens, in most states, including New Jersey, generally only apply to labor and materials that enhance the equipment's value, not to charges for maintenance, storage or application of gas, oil or grease.[732] In New York, however, if the garage keeper can show that the nonenhancement services were done in the ordinary course as a necessary preliminary step to the repair process then the mechanic may be able to recover these charges.[733]

(ix) *Attorney Charging Liens*

Attorney charging liens, which are generally non-possessory, are subordinate to a perfected secured creditor.[734]

730 C.R.S. 38-20-106.

731 See In Re Cam Trucking LLC, 2014 WL 4639923 (Bankr. D. Ariz. Sept. 9, 2014).

732 Ferrante Equipment, supra 49 N.J. 432.

733 See Mickey's Clan, Inc., 452 N.Y.S.2d 555.

734 See In Re Trump Entertainment Resorts, Inc., 2014 WL 6885977 (Bankr. D. Del. Dec. 5, 2014).

V

SECRET LIENS

(A) UCC Secret Liens

It is every practitioner's hope to identify all possible liens and competing claims before closing. Consistent with this concern, the primary objective of Article 9 is to make the law of secured transactions relatively simple and predictable, with minimal surprises and traps, under a system that focuses on transparency. Secret liens are a particularly pernicious pitfall.

(i) *Automatic Perfections*

Whenever a lien is automatically perfected it is by definition a secret lien. As noted in the section on perfecting liens, there are a number of cases under Article 9 where liens are automatic and are perfected without filing, possession or control. In each of these cases, a potential secured party cannot be sure it will receive a first lien position. These automatic and secret liens include:

(a) Insignificant assignments of accounts.[735]
(b) Health care insurance receivables assigned to provider.[736]
(c) Sales of promissory notes and payment intangibles.[737] In the case of promissory notes, however, if the buyer left the seller in possession of

735 See U.C.C. § 9-309(2).
736 See U.C.C. § 9-309(5).
737 See U.C.C. § 9-309(2), (3) and (4).

the promissory note, the new secured party can obtain a fair degree of protection by taking possession of the promissory note. Once the secured party has possession of the promissory note, it should have priority because perfection by possession trumps automatic possession. Moreover, the secured party can deny the prior purchaser holder in due course status because this status requires possession. However, in the case of payment intangibles the secured party cannot take possession, and thus, cannot reasonably protect itself from a possible prior sale without significant investigation.

(d) Depository bank's liens and rights of setoff in deposit accounts with the bank. As noted above, a secured party can only perfect a lien in a deposit account through control. Even control, however, does not trump the depository bank's security interest or right of setoff or recoupment.[738] The secured party only trumps the depository bank when the secured party obtains a subordination or waiver of the bank's security interest and a waiver of the bank's right of setoff or recoupment, or the secured party becomes the depository bank's customer.[739]

(e) Investment Accounts: Like a depository bank, security interests created by a broker or securities or commodities intermediary are automatically perfected and thus are secret liens.[740] Note also that perfection in a security account automatically perfects a lien in securities entitlements.

(f) Letters of Credit: Issuer or nominated party has priority.[741]

(g) Estates.[742]

(h) Proceeds[743]: See Priority of Liens Section, supra.

(i) Supporting obligations.[744]

(j) PMSI in consumer goods.[745]

738 See U.C.C. §§ 9-327 and 9-340(b).

739 See U.C.C. §§ 9-327(4) and 9-340(c).

740 See U.C.C. § 9-309(10) and (11).

741 See U.C.C. § 5-118.

742 See U.C.C. § 9-309(13).

743 See U.C.C. § 9-315.

744 See U.C.C. § 9-308(d).

745 See U.C.C. § 9-309(1).

(ii) ***Temporary Automatic Perfections:***

(a) PMSI: As noted above, a UCC-1 filing for a PMSI may be filed any time within 20 days of the debtor receiving the goods, and it will be deemed to be effective retroactively to the date of possession. Thus, when the debtor already has possession of the goods, a secured party should wait at least 20 days and then confirm no PMSI filing has been made before providing financing in connection with the goods. This issue can, however, still be problematic when the collateral is equipment delivered in multiple installments. See PMSI discussion, supra.

(b) As also noted above, with respect to instruments, certificated securities and negotiable documents, security interests may be perfected for twenty days without filing.[746] During this twenty-day period a secret perfected lien exists, much like that of a PMSI.

With regard to negotiable instruments, the new lender could claim the status of holder in due course, a status that would entitle it to take free and clear of any lien of which it was unaware.[747]

PRACTICE TIP: Absent one of the two above exceptions, if the original lender continues its perfection by filing within the twenty day period, the original creditor will prevail. Thus, to protect itself, the new lender must thoroughly investigate the transactional source of certificated securities, instruments and negotiable documents.

In the case of a document, the new lender can achieve the status of holder in due course, through "due negotiation."[748] In this case, however, the negotiation must have been in the ordinary course of the transferor, and the new lender must have acted in good faith and must not have notice of any adverse claim. Thus, if a lender has a lien in goods that are subsequently placed in a warehouse by the debtor and the debtor receives a negotiable document, a person to whom the negotiated document is "duly negotiated" will trump the lender.[749] If, however, the lender did not give the debtor apparent authority to obtain the warehouse receipt and did not consent to the issuance of the receipt, the

746 See U.C.C. §§ 9-312 (e), (f) and (g); 9-313(h).

747 See U.C.C. § 3-305(a)(1).

748 See U.C.C. §§ 7-501(1), (4).

749 See U.C.C. §§ 7-502(1) and 9-331(a).

lender will prevail.[750] A security interest in goods covered by a non-negotiable document may be perfected by giving notice to the bailee of the security interest, filing or by the bailee issuing the document in the name of the secured party. Clearly, the lender needs to inquire about the whereabouts and possession of the goods.

Note: If the goods are held by a bailee without a negotiable or non-negotiable document the secured party can perfect by filing or possession through a bailee. The bailee must acknowledge in writing that it holds the goods for the secured party's benefit.

(c) Liens in proceeds are automatically perfected for twenty (20) days.[751] Thus, if the secured party timely continues the lien, it may trump the liens of others, depending on the order of a filing or perfection.[752]

(iii) *Ordinary Course Sales Subject to Pre-Existing Liens*

A basic tenet of Article 9 is that ordinary course sales are free and clear of liens of the seller. Thus, it is commonly understood that all purchases from a seller in the ordinary course of the seller's business are free and clear of all liens. This is a common misunderstanding.

It is also a basic tenet of Article 9 that a sale outside the ordinary course is subject to the secured party's lien.[753] Thus, when a debtor sells equipment that is subject to an Article 9 lien, outside the ordinary course the equipment is subject to the secured party's lien even if the buyer is a vendor of that type of equipment.[754] When the vendor re-sells the equipment in the ordinary course of its business, the sale will be free and clear of the vendor's creditors' liens, but it will not be free and clear of the original debtor's lien unless the original debtor's lien holder entrusted the goods to the seller or otherwise consented to the sale. As a result, whenever financing the purchase of used equipment, even where the seller is an ordinary course seller such as a dealer, the secured party must research the origin of the used equipment to confirm no liens existed before the ordinary course seller's acquisition.

750 See U.C.C. § 7-503(1).

751 See U.C.C. § 9-315(c) and (d).

752 See U.C.C. § 9-322.

753 See U.C.C. § 9-315(a)(1) cmt. 2.

754 Id. But see, John E. Cargill, *Entrustment Under U.C.C. Section 2-403 and Its Implications for Article 9,* Campbell Law Review, Vol. 9 (Issue 2, Spring 1987) (Battle between Articles 2 and 9 for priority in BIOCOB sale).

(iv) *Sellers of Goods*

Article 2 provides sellers of goods with certain rights that can trump an Article 9 lien although the seller does not have a security agreement and did not file a UCC-1.

A seller of goods that has identified them to the contract (thus giving the buyer an interest in goods) but has not yet delivered them can create a security interest in the goods or can reject the sale.[755]

A seller who delivered goods to the buyer can reclaim them within 10 days of receipt by the buyer if the seller has learned the buyer is insolvent.[756] If the buyer made financial misrepresentations as to its solvency in writing within three months of delivery, there is no ten-day limit. This right of reclamation is subject to the rights of a buyer in the ordinary course and of a good faith purchaser for value, including a "pre-existing" lender with an after-acquired collateral clause.[757] A lender may be a "good faith purchaser for value" but not a "buyer in the ordinary course."[758] Under the standard version of the U.C.C. a trustee in bankruptcy would trump the reclaiming seller, but some states, like New York have deleted "or lien creditor" from the first sentence of U.C.C. § 2-702(2), thereby precluding a trustee from invoking the strong-arm provisions of 11 U.S.C. Section 544.

(v) *Returned Goods*

Returned goods are generally proceeds of the account or chattel paper generated by the sale. However, if the inventory lender remains unpaid its lien will re-attach upon return so long as its lien is still perfected. The account lender is out of luck. The chattel paper lender is out of luck unless it took the chattel paper under circumstances that gave it priority over the inventory lender's claim to it as "proceeds."[759]

---

755 See U.C.C. § 2-702. See also Crocker Nat'l Bank v. Ideco Div. of Dresser Indus., Inc., 839 F.2d 1104 (5th Cir. 1988).

756 See U.C.C. § 2-702(2).

757 See Stowers v. Mahon (In Re Samuels & Co.), 526 F.2d 1238 (5th Cir. 1976); see also Shelby Cnty. State Bank v. Van Diest Supply Co., 303 F.3d 832 (7th Cir. 2002).

758 See U.C.C. §§ 1-201(b)(9), 1-201(b)(32) and 2-403.

759 See U.C.C. §§ 9-330(a) and (c), 9-332. The chattel paper financier must have purchased for new value and must have taken possession but in the ordinary course of its business. ("Purchase" includes taking as security. The chattel paper financier must either take possession of the returned goods or file as to the returned goods.)

(vi) ***Goods in Transit***

A seller of goods also has the right to stop delivery of large shipments of goods in transit in the possession of a carrier or other bailee.[760] However, if the goods are the subject of a negotiable document, the carrier or bailee is not obligated to obey a stop order unless the negotiable document is delivered to it.[761] Notably, "not obligated to obey" may not mean "can't obey."

(vii) ***After-Acquired Liens***

Because after-acquired liens apply to collateral that does not yet exist and is replaced or created periodically in the future, after-acquired liens are vulnerable to losing their priority to a subsequent PMSI. As noted below in the Non-UCC Secret Liens section, after-acquired liens are also vulnerable to subsequent IRS liens.[762]

(viii) ***New Debtor***

Arguably, there may also be lien perfections that are tantamount to secret liens where the debtor changes it name or there is a "new debtor", and the original secured creditor perfects its original lien within the time prescribed, such as four months of a location change. See Maintaining Perfection and Priority When Circumstances Change After Closing, Section III(D), supra.

(B) Non-UCC Secret Liens

(i) ***Industry and State Specific Liens*****:** It is not possible to identify all the possible non-Article 9 liens that may be created by statute or common law. By way of example only, the May 1, 2008 draft Hidden Liens Report issued by the Committee of the Business Law Section of the State Bar of California lists 145 secret liens in California alone.[763] A few specific examples are as follows:

760 See U.C.C. § 2-703(2)(b) and (3)(b); U.C.C. § 2-705(1) cmt. 1.

761 See U.C.C. § 2-705(3)(c).

762 See 26 U.S.C. § 6321 (2012).

763 John Francis Hilson, Jeffrey S. Turner, Peter Weil, ASSET BASED LENDING: A PRACTICAL GUIDE TO SECURED FINANCING, 1-25 (5th ed. 2002).

(a) Ranchers' liens arising when ranchers provide cattle to meat packing companies;[764]
(b) Sellers of fresh or frozen fruits and vegetables;[765]
(c) The Federal Food Security Act;[766]
(d) Sureties in the construction industry;[767]
(e) Wage claims in Wisconsin;[768] and
(f) Union Pension Trust Fund liens. [769]

As noted above, agricultural non-possessory liens may arise automatically and without public notice. Other industries may have similar industry specific liens. This is an area in which the old adage, "know your borrower" applies with a vengeance. The secured party should be familiar with the debtor's business and industry and any industry specific liens that may apply.

(ii) ***Federal Tax Liens*:** A IRS federal tax lien attaches to the taxpayer's property when assessed. As noted above with regard to priority of future advances and after-acquired provisions, an IRS tax lien encompasses not only property currently owned, but also after-acquired property to wit, property acquired more than 45 days after the tax lien is properly recorded.[770] The rights of secured parties, purchasers, and other lienholders are, however, protected until notice has been properly recorded by the IRS.[771] Significantly, the IRS is not bound by the rule requiring filings against the exact legal name of the debtor.[772] Thus, searches must also be ordered on any name on any tax return or quarterly report. State law generally dic-

764 See 7 U.S.C. § 196 (2012); Liberty Mut. Ins. Co. v. Rotches Pork Packers, Inc., 969 F.2d 1384 (2d Cir. 1992).

765 See 7 U.S.C. § 499a et seq. (2012). The Perishable Agricultural Commodities Act is commonly known as "PACA". Under PACA a trust is created in the assets of the buyer for the benefit of the seller. The PACA trust is a non-segregated floating trust with no limitations on commingling. As a result, a PACA seller has rights to the amount due and owing regardless of whether the commodities, derivative products or proceeds are identifiable. The lien does not require filing for perfection.

766 See 7 U.S.C. § 1631 et seq. (2012).

767 See Nat'l Shawmut Bank v. New Amsterdam Cas. Co., 411 F.2d 843 (1st Cir. 1969).

768 Wis. Stat. §109.09(2); SEC v. Wealth Mgmt., LLC, 2010 WL 3701784 (E.D. Wis. Sept. 15, 2010).

769 See 29 U.S.C. § 1368(c) (2012).

770 See 26 U.S.C. § 6321 (2012).

771 See 26 U.S.C. § 6323(a). See Glass City Bank v. United States, 326 U.S. 265 (1945).

772 In Re Spearing Tool & Mfg. Co., 412 F.3d 653 (6th Cir. 2005).

tates where the filing must be made.[773] If state law is silent, the filing is made with the clerk of the United States district court where the property is located.

(iii) ***Warehouse Liens*****:** A warehouse lien on goods is valid against the depositor and any secured party that acquiesced in the deposit of the goods.[774] Acquiescence may be inferred from the totality of the circumstances.[775]

(iv) ***Sureties*****:** The subrogation rights of sureties generally trump a perfected secured party in accounts or proceeds.[776] The surety's priority is limited, however, to funds applicable to the contract at issue.[777] If the surety's rights purport to go beyond that of an ordinary surety, such rights must be perfected under Article 9.[778]

(v) ***Garage Keeper And Landlord Liens*****:** If the debtor has stopped operating or is in severe debt, the secured party often finds that the collateral is in the possession of a third party. That third party is often the debtor's landlord, mechanic, or warehouse, which has stored or repaired the collateral and has not been paid in full. As noted above, possessory liens such as landlord's liens and garage keeper's liens generally have priority over Article 9 liens unless the applicable non-Article 9 law expressly provides otherwise.[779]

(vi) ***Environmental or Judgment Liens*****:** Judgment liens are generally not a lien on personal property until there has been a levy or execution submitted to the sheriff or marshal. The submission of the levy or execution to the sheriff is, however, generally not recorded in a public record. Fortunately, however, judgments are publicly recorded. Thus, in addition to UCC searches, a secured party should also order judgment and environmental lien searches wherever the debtor or its property are located.

---

773 See 26 U.S.C. § 6323(a).

774 See U.C.C. § 7-209.

775 See U.C.C. § 7-209 cmt. 1.

776 See State Bank & Trust Co. v. Ins. Co. of the W., 132 F.3d 203 (5th Cir. 1997); Travelers Cas. & Sur. Co. v. Target Mech. Sys., Inc., 800 N.Y.S.2d 358, 6 Misc. 3d 1003A (N.Y. Sup. Ct. 2004).

777 See Transamerica Ins. Co. v. Barnett Bank, 540 So.2d 113 (Fla. 1989).

778 See In Re Kuhn Constr. Co., 11 B.R. 746 (Bankr. S.D.W. Va. 1981).

779 See U.C.C. § 9-333 and § 9-334.

(vii) ***Fair Labors Standard Act*:** Under the "hot goods" provision, one may not ship or sell goods if employee wages involved in the production of the goods were not paid. Under this provision the U.S. Supreme Court has even upheld an injunction upon a secured party from selling inventory manufactured by employees whose wages were not paid.[780]

(viii) ***Cooperative Liens*:** As noted above, cooperative agreements are within the scope of Article 9. Liens for maintenance and late charges likely trump even a PMSI reflected secured creditor.[781]

780 See Citicorp Indus. Credit, Inc. v. Brock, 483 U.S. 27 (1987). This prohibition should be limited to inventory, and should not extend to equipment, etc.

781 See In Re McCoy, 496 B.R. 678 (Bankr. E.D.N.Y. 2011).

VI

BANKRUPTCY AND FRAUDULENT TRANSFERS

While it is beyond the scope of these materials to address the United States Bankruptcy Code ("Code") at length, it is necessary to briefly review the "strong-arm," "preferences," and "automatic stay" provisions as they relate to Article 9 liens.[782]

(A) Bankruptcy

(i) *Strong Arm Provision*

The strong-arm provision of the Code provides that the trustee in bankruptcy (or a debtor in possession) automatically, upon filing of the bankruptcy petition, obtains, inter alia, the status and all benefits of a judicial lien creditor and bona fide purchaser of real property.[783] Thus, if at the time of the bankruptcy filing a secured party has not yet perfected its lien on personal property collateral, the secured party will automatically

782 The reader is also reminded of the bankruptcy code preclusion of after acquired clauses. See discussion of after acquired clauses in Chapter II (B), supra.

783 The seller of an account, chattel paper, payment intangibles or a promissory note in a true sale does not retain any property interest in the sold property. U.C.C. § 9-318(a) cmt. 2. However, "while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold." U.C.C. § 9-318(b). This provision addresses the case in which the debtor re-sells the asset before the purchaser perfects its interest. In this situation, the second purchaser acquires the ownership and has priority over the first purchaser.

lose its secured position to the trustee. This provision is frequently invoked by bankruptcy trustees, and, as noted below, can be particularly lethal against secured parties when coupled with the preference provisions of the Code. Indeed, one of the first things a new trustee will do is review the alleged liens of all secured parties to determine whether the trustee can trump any secured party on its collateral.[784]

(ii) *Preferences*

The strong-arm provision can be expanded substantially when coupled with the "preference" provisions of the Code. The preference provisions generally provide that the trustee (or a debtor in possession) may vitiate any transfer by the debtor to a creditor within 90 days (in some cases, one year)[785] before the bankruptcy filing when the transfer was on an "antecedent" debt. An antecedent debt is simply pre-existing debt. The filing of a financing statement or other action perfecting a lien is considered a transfer under the preference provisions. Thus, if a secured party does not file a financing statement contemporaneously with a secured transaction with the debtor, but then subsequently files to perfect its lien within 90 days of the bankruptcy filing, the trustee may attack the filing as a preference. If the trustee prevails, it will vitiate the lien and thereby deny the secured party its collateral in the bankruptcy. This scenario is quite common, especially in cases in which the secured party originally filed in the wrong state or under the wrong name: The debtor defaults on its loan, the secured party reviews the file, discovers its filing error and promptly re-files to correct the error, only to see the debtor file a petition in bankruptcy within 90 days of the correct filing.

One possible safe haven for the secured party is that the Code provides that there is no preference if the financing statement filing or other means of perfection became effective within 30 days of the transaction.[786] In other words, so long as the secured party perfects the lien within 30 days of the transaction, the lien perfection will relate back to the transaction as if it were contemporaneous, and thus, not a preference. Thus, in effect, the Code provides the equivalent of a thirty-day grace period for perfection, similar to the 20-day grace period for a PMSI, but the Code's 30-day grace period applies to all secured transactions and is not limited to purchase money filings.

While the Code's 30-day provision would appear to extend the PMSI's 20-day period an additional 10 days, for those PMSI secured parties that missed the 20-day

784 See 11 U.S.C. § 544(a).

785 See 11 U.S.C. § 547(b)(4).

786 See 11 U.S.C. § 547(2)(A) (2010).

deadline, the Code's provision only protects the secured party from the trustee, not other Article 9 secured parties. Thus, if a PMSI secured party files 25 days after the debtor's taking possession of the collateral, the secured party is safe from a preference claim, but may still lose its lien to a secured party of the debtor with an after-acquired lien, since the after-acquired lien automatically attached to the collateral on the 21st day after the debtor took possession.

(iii) *After-Acquired Collateral*

If the creditor has a lien on inventory or accounts receivables, such as when it has a blanket asset lien, it has additional rights in the event of a bankruptcy filing. Accounts receivable and inventory are considered cash collateral under Section 363 of the Bankruptcy Code. Because "cash collateral" can quickly and easily disappear, this is one of the few areas in which the Bankruptcy Code puts the burden of taking immediate action on the debtor, instead of the creditor. The Bankruptcy Code prohibits a debtor from using the cash collateral, in whole or in part, without the consent of the creditor or without a court order.[787] The debtor cannot even make payroll or pay its ordinary course expenses without the cash collateral creditor's consent or the permission of the court. Consequently, a cash collateral lien gives the creditor a great deal of leverage if the debtor needs the cash collateral to operate postpetition, which is the case in the vast majority of Chapter 11 proceedings.

The Trustee or debtor will often try to argue that the secured party's pre-petition lien does not apply post-petition under 11 U.S.C. § 552(a), as the bankruptcy code does not recognize after-acquired collateral provisions, The secured party should zealously oppose most such claims, citing § 552(b)(1), which extends a creditor's pre-petition lien to the post-petition proceeds of pre-petition collateral. That provision reads:

> **(b)(1)** Except as provided in Sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy

787 See 11 U.S.C. § 363(c)(2) (2010).

> law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

Under this section a secured party's pre-petition lien in accounts, inventory and collateral such as general intangibles must be extended, even post-bankruptcy, to their proceeds. Often, post-petition cash and checks are the proceeds of pre-petition accounts or inventory. And post-petition accounts receivables are often the proceeds of pre-petition contracts, which are general intangibles. Accordingly, the secured party's pre-petition security interest often extends to the post-petition payments received as well as to accounts receivables generated post-petition.

A pre-petition lien in contracts, to wit, "general intangibles" under Article 9 can be extended quite far post petition under the Section 552(b)(1) proceeds exemption. On point is Cadle Co. v. Schlichtmann, 267 F.3d 14, 20-21 (1st Cir. 2001).[788] In Cadle, a creditor had a security interest in a law firm's contingency fee agreement and the proceeds from that agreement. Although much of the work was performed after the firm had dissolved and an individual lawyer had filed for bankruptcy, and although the right to payment arose post-petition, the First Circuit held that the creditor had a security in the post-petition fees under § 552(b)(1).

Also instructive is United Virginia Bank v. Slab Fork Coal Co., 784 F.2d 1188, 1191 (4th Cir. 1986). That decision involved rights under a coal supply contract entered by the debtor pre-petition. The Court held that payments for coal supplied post-petition were subject to a creditor's pre-petition lien. The Court reasoned that creditor "UVB's rights under Slab Fork's contract with Armco were likewise intangible rights, and were subject to UVB's lien before the filing of the bankruptcy petition. It is true that coal had to be supplied to Armco by or for Slab Fork before any right to payment arose, but that is true for all the payments under the contract, whether generated pre-petition or post-petition. No change in the right to payment under the Armco contract was brought about by the filing of a bankruptcy petition, where the underlying asset and all proceeds therefrom were subject to a valid pre-petition security interest." Id. at 1191.

The U.S. Supreme Court, however, long ago confirmed, a significant exception to the Section 552(b) exclusion.[789] The Supreme Court held there is no enforceable post-

788 The pre-petition lien may not, however, continue post-petition if the lien was not in the underlying contracts, but rather was only in the payments due under the contracts. See In Re Lake at Las Vegas Joint Venture, LLC, 497 Fed. Appx. 709 (9th Cir. 2012) (where the pre-petition lien is its payment under a contract, but not the contract itself, payments post-petition are not subject to the pre-petition lien).

789 See Local Loan Co. v. Hunt, 292 U.S. 234 (1934).

petition lien on property "not existent when the bankruptcy became effective or even arising from, or connected with preexisting property, but brought into being solely as the fruit of the subsequent labor of the bankruptcy."[790] A debtor's/trustee's avoidance claims such as preference claims are also generally not considered the subject of any pre-petition liens or the proceeds of same.[791] For example, a depository bank's pre-petition lien on the funds in a deposit account does not give the bank any claim to the trustee's fraudulent conveyance avoidance action to recover funds fraudulently paid out of the depository account.[792] The pre-petition liens would also not apply to newly issued stock in a debt equity swap under a Plan of Reorganization.[793] Similarly, a pre-petition lien would not carry over to adequate protection payments and plan distributions after an internal spinoff of a Chapter 11 debtor.[794]

Hotel and motel receipts are cash collateral under the Bankruptcy Code.[795] Prior to the 1994 amendments to the bankruptcy code the issue of whether hotel and motel receipts were cash collateral often turned on whether under state law the receipts were deemed "rents" (in which case the secured party perfected by filing an Assignment of Rents) or "accounts" (in which case the secured party perfected by filing under Article 9). If the receipts were deemed rents the post-petition receipts were deemed cash collateral, as they were the proceeds of a pre-petition lien in the real estate. If the receipts were deemed accounts, the post-petition receipts were not deemed cash collateral, as they were not considered to be the proceeds of any pre-petition personal property (Article 9) lien. Under the 1994 amendments the issue was resolved in favor of secured parties, with hotel and motel receipts being deemed cash collateral regardless of whether they are rents or accounts under state law. Section 552(b)(2) was amended to provide that a

790 Id. at 243. In this vein, the pre-petition security interest arguably only continues postpetition if "the debtor need not do anything after bankruptcy to make them continue." Towers v. Wu, 173 B.R. 411, 413-415 (B.A.P. 9th Cir. 1994). See also In Re Premier Golf Properties, LP, 477 B.R. 767 (BAP 9th Cir. 2012) (Post-petition green fees and driving range fees did not constitute cash collateral) Johnson v. Cottonport Bank, 259 B.R. 125, 128-129 (W.D. La. 2000); In Re Rumker, 184 B.R. 621 (Bankr. S.D. Ga. 1995). But see Cadle Co., 267 F.3d 14; United Va. Bank, 784 F.2d 1188, supra.

791 See In Re Residential Capital, LLC, 497 B.R. 403, 414-15 (Bankr. S.D.N.Y. 2013) (citing In Re Demma Fruit Co., 2002 Bankr. LEXIS 1781 at *11 (Bankr. D. Neb. May 28, 2002); and 5 COLLIER ON BANKRUPTCY 552.02[5][d] (16th ed. rev. 2013).

792 See In Re Abeles, LLC, 2013 WL 5304014 (Bankr. E.D.N.Y. Sept. 20, 2013).

793 See BOKF, N.A. v. JPMorgan Chase Bank, N.A. (In Re MPM Silicones, LLC), 518 B.R. 740 (Bankr. S.D.N.Y. 2014).

794 See Delaware Trust Company v. Wilmington Trust, N.A. (In Re Energy Future Holdings Corp.), 2016 WL 944608 (Bankr. D. Del. Mar. 11, 2016).

795 See 11 U.C.C. § 552(b)(2).

pre-petition lien in hotel and motel receipts continues in receipts received post-petition, and Section 363(a) was amended to include hotel and motel receipts within the definition of cash collateral. Of course, the secured party still needs to make sure it is properly perfected under applicable state law, depending on whether hotel and motel receipts are deemed rents or accounts under the particular state of the situs of the hotel.[796]

Not all income generated by real property, however, is rent within the scope of an assignments of rents.[797]

(B) Fraudulent Transfers In Secured Transactions

Many states have adopted the Uniform Fraudulent Conveyance Act now known as the Uniform Fraudulent Transfer Act.[798] The United States Bankruptcy Code also has a provision for fraudulent transfers.[799] In the event of a bankruptcy filing the Trustee or debtor may invoke the state or bankruptcy fraudulent conveyance laws.

Article 9 secured parties rely heavily on the value of their collateral and their right of recourse to the collateral in the event of default. Indeed, secured parties take great pains to make sure their liens are properly perfected so no one, not even a bankruptcy trustee, can deny them their recourse rights to the collateral. There is a body of law, however, that may allow a bankruptcy trustee to deny a timely and properly perfected secured party its collateral, as much as six years after the loan closing.[800] This body of

796 See definition of "accounts."

797 See, e.g., In Re McCann, 140 B.R. 926 (Bankr. D. Mass. 1992) (security interest in the rents and profits of a golf course do not extend to greens fees). See also United States Dep't of Hous. & Urban Dev. v. Hillside Assocs. (In Re Hillside Assocs. Ltd. P'ship), 121 B.R. 23, 24 (B.A.P. 9th Cir. 1990) ("[M]oney paid for the care of nursing home patients can no more be described as "rents" than could hospital bills. That the patients live there is incidental to the fact that the nursing home is providing them with care."); In Re Zeeway Corp., 71 B.R. 210 (B.A.P. 9th Cir. 1987) (gate receipts at a racetrack are not "rents"); In Re Cafeteria Operators, L.P., 299 B.R. 400, 405 (Bankr. N.D. Tex. 2003) (revenues generated by services of the debtors' restaurant operations were not subject to creditor's prepetition security interest).

798 The Uniform Fraudulent Conveyance Act was originally promulgated in 1968 and adopted by 25 states. The Act was revised and reissued in 1984 as the Uniform Fraudulent Transfer Act ("UFTA"). The UFTA has been adopted in at least 43 states, the District of Columbia and Puerto Rico.

799 See 11 U.S.C. § 548 (2007).

800 The statute of limitations for Fraudulent Conveyance claims under the Bankruptcy Code is two years, but the state statutes often have statute of limitations provisions of 4-6 years.

law is best summarized in a review of the recent bankruptcy case of In Re TOUSA, Inc., 680 F.3d 1298 (11th Cir. 2012).

TOUSA was the thirteenth largest home building in the United States, with many subsidiaries. TOUSA and one of its subsidiaries, Transeastern were obligors to Transeastern's lenders. In 2005, TOUSA and Transeastern defaulted on the loans and litigation ensued. This default triggered defaults on many other loans where TOUSA was an obligor with other subsidiaries. In order to settle the Transeastern litigation the "other subsidiaries" put up assets valued at more than $400 million as collateral for loans from "New Lenders" to pay off the "Transeastern Lenders." In 2007, about six months after the settlement, TOUSA and all of the subsidiaries filed for bankruptcy.

The Creditor's Committee in the bankruptcy then filed an action against the New Lenders to vitiate their liens on the collateral posted by the other subsidiaries, and to thereby turn the New Lenders' $400 million claim from secured to unsecured. The Creditor's Committee argued that the other subsidiaries granting a lien on their assets to secure a loan where the loan proceeds were used to pay off loans the other subsidiaries were not liable for, to wit, the Transeastern loans, was a fraudulent conveyance. The Creditor's Committee also sued the Transeastern Lenders under the same legal theory. There were three courts and three different opinions.

The Creditor's Committee won on all counts. In short, the fraudulent conveyance law holds that if the other subsidiaries were not liable for the Transeastern loans, then their putting up their collateral for new loans to pay of the Transeastern Lenders is a fraudulent conveyance as against the New Lenders and The Transeastern Lenders if:

1. The other subsidiaries did not, directly or indirectly, get the "reasonable equivalent" value of their collateral, and
2. At the time of the closing the other subsidiaries were insolvent or became insolvent as a result of the granting of the lien in their collateral.

The court concluded the other subsidiaries did not get reasonably equivalent value since they didn't get anything except a six month delay of the bankruptcy of their parent company, TOUSA: notably the other subsidiaries were not guarantors of the Transeastern loans. The court also concluded the other subsidiaries were insolvent at the time of the closing, especially when all entities ended up filing for bankruptcy within six months of the closing.

The first lesson here is for secured parties making new loans: BEWARE the loan where the loan proceeds do not go directly to the party pledging the collateral or for their direct benefit. If loan proceeds are not going to or for the direct benefit of the party pledging the collateral, there must be a review of whether said party is obligated on the debt, such as with a guaranty, and there must be a full and thorough analysis of the finances of the party pledging the collateral to confirm they are not insolvent and will not become insolvent as a result of the transaction.

The second lesson is for secured parties accepting payoffs: BEWARE the payoff coming from a source other than the borrower. This issue is similar to the bankruptcy preference law concerns of any secured party accepting a payoff. Here, however, the exposure is not limited to 90 days, but can run into years since the state statutes of limitations for fraudulent conveyances is generally four to six years. Notably, the Transeastern Lenders may have been able to defeat the Creditor's Committee's claims if they had obtained a guaranty from the other subsidiaries at the time of the original loans, since the subsidiaries would have then received "reasonably equivalent" value in exchange for their pledging the collateral because the subsidiaries were obligated to pay the debt under their guaranties. But the guaranties must not be vulnerable to attack. For example, if the guaranties were entered within the statute of limitations for fraudulent conveyances (4–6 years) and the other subsidiaries did not receive reasonably equivalent value for the guaranties, the subsidiaries guaranties themselves could be vitiated and the payoff again recaptured by the Creditor's Committee, if the subsidiaries were insolvent at the time of entering into the guaranties. If the guaranties were vitiated, then the secured parties would be back in the same position as if they had never obtained guaranties: the subsidiaries would then not be legally obligated to pay the debt and thus deemed not to have received "reasonably equivalent" value when they pledged the collateral. It should be noted that this "upstream" (a subsidiary acting for the benefit of a parent) pledge problem also applies to upstream guarantees payments. Regardless of who receives the loan proceeds or pledges the collateral, when a secured party obtains a guarantee from a subsidiary any payments by the subsidiary pursuant to the guaranty are at risk to fraudulent conveyance claims. In short, the Courts have often held that while a parent benefits from a loan to a subsidiary, a subsidiary does not benefit from a loan to a parent.

The "second transferee" doctrine may sometimes insulate a secured party from a fraudulent conveyance claim in bankruptcy[801]. This doctrine generally provides that if there is an intermediary transferee between the alleged fraudulent

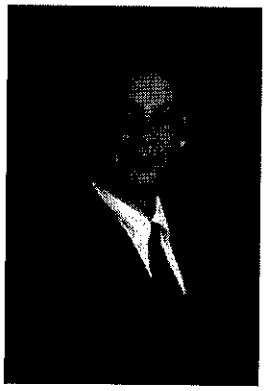
801 11 U.S.C. §550(b)(1).

conveyance transferor and the ultimate recipient, the transfer cannot be held to be fraudulent. The 11th Circuit in TOUSA, however, rejected this argument and stated that the Court had to look beyond the particular transfers in question to the entire circumstances of the transactions when deciding whether the lenders controlled the transaction.[802]

802 See In Re Tousa, supra. See also Richardson v. United States (In Re Anton Noll, Inc.) 277 B.R. 875 (B.A.P. 1st Cir. 2002).

ABOUT THE AUTHORS

Frank Peretore, Esq. and Robert L. Hornby, Esq. are Co-Chairs of Chiesa Shahinian & Giantomasi PC's Equipment Leasing and Financing Group. Chiesa Shahinian & Giantomasi is a full-service law firm with extensive equipment leasing and financing experience, ranging from the transactional stage through the workout, litigation, repossession, bankruptcy, and foreclosure stages. Chiesa Shahinian & Giantomasi represents national, international, and captive equipment leasing companies, commercial banks, and alternative lending financial institutions in state, federal, and bankruptcy courts. With a history spanning over 40 years in New Jersey and New York, Chiesa Shahinian & Giantomasi continues to advance our clients' legal and business successes through in-depth insight and creative solutions.



Frank Peretore, Esq. – Mr. Peretore has over 30 years of experience in equipment leasing and asset based lending and was nominated by *Leasing News* in 2015 as one of the 25 most influential attorneys in the U.S. in the Equipment Leasing and Finance Industry. He represents national and regional finance companies and banks ranging from closely held companies to *Fortune* 100 companies. Mr. Peretore's representation includes the enforcement of lessors' and secured creditors' rights in thousands of matters in the state, federal, and bankruptcy courts.

Mr. Peretore received his law degree from Georgetown University Law Center, and his undergraduate degree from the State University of New York College at Oneonta. As a long-standing leader in his field, Mr. Peretore has also published a highly-acclaimed book titled "Workouts and Enforcement for the Secured Creditor and Equipment Lessor" (Lexis/Nexis 2015 edition).

Robert L. Hornby, Esq. – An experienced litigator, Mr. Hornby represents national and regional banks and finance companies in all aspects of equipment leasing, asset based lending, and civil litigation in New York and New Jersey state and federal courts. Mr. Hornby regularly counsels clients on a wide range of matters unique to the equipment finance and leasing industry, from drafting master documentation to the enforcement of lessors' and secured creditors' rights.

Mr. Hornby received his law degree *cum laude* from Seton Hall University School of Law, and his undergraduate degree *cum laude* from the University of Arizona. He served as a Judicial Law Clerk for the Honorable David S. Baime, PJAD (ret.) in the New Jersey Appellate Division.

INDEX

96036354R00113

Made in the USA
San Bernardino, CA
18 November 2018

ISBN 978-1-4960-7863-6